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The Statutory Foundations of Corporate Capitalism, 1865-1900:

States and the Law in the Formation of the American Political Economy

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The Statutory Foundations of Corporate Capitalism, 1865-1900:

States and the Law in the Formation of the American Political Economy

by

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Dedicated to

Dr. Donna Lieberman

With Gratitude and Affection

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The Statutory Foundations of Corporate Capitalism, 1865-1900:

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America is a nation founded on rule by the people, yet the federal system designed to protect individual power paradoxically contributed to the concentration of power in business corporations. Nineteenth century corporations had been owned and controlled by proprietors. After 1900 corporations became much larger, with ownership separated from management, and with managers in control. The new system of corporate capitalism required a new set of legal rights. Existing scholarship claims these rights were constructed via judicial interpretation of antitrust law. However, there are two ways to regulate the corporation: antitrust law and statutory law. The second is arguably the stronger of the two, and in America it was crafted in the several states. Elements of state law included provisions for corporate creation, internal governance, liability, and consolidation. I argue that federalism shaped corporate capitalism, and led to the concentration of corporate power in America. Because there is no extant systematic data on state corporation law, I construct a dataset tracing development of these provisions in 35 states over 35 years. I analyze the provisions according to section, time, level of economic development, and degree of capital concentration. Minutes of state constitutional conventions provide evidence of the arguments for and against the various provisions. Results show variation between and within sections. States sought to preserve their authority to regulate their local economies, and yet also promote development. They promulgated laws specific to the industrial structure of their state: those with capital concentrated in a few firms were more likely to lift restrictions. This places the well-known New Jersey innovations of the 1890's in a new light. New Jersey drew from provisions already existing, but not assembled in one place. Richard Bensel argues that national market building was protected by the most insulated branch of government, the Supreme Court. Yet state legislatures, the least insulated branch, acted as well. As states liberalized their laws to accommodate the national market, they lost regulatory capacity. This loss of regulatory authority was necessary precursor for 20th century national administrative statebuilding.

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Chapter 1

Corporate Capitalism and the States

America is a nation founded on rule by the people, yet the federal system designed to protect individual power paradoxically contributed to the concentration of power in business corporations. Federalism, along with separation of powers serves to disperse power among institutions. It decentralizes many functions of government. In the American system the state governments are generally considered to be closest to the people. Yet the very system of that James Madison thought would help protect against the concentration of power set states in competition with one to develop their local economies. The system of state chartering of business corporations led to a monumental concentration of wealth and power.

At the dawn of the twentieth century the American political economy was in transition. Nineteenth century corporations had been proprietary, controlled by majority shareholders, and run largely as family operations. Now a massive merger movement transformed the structure of corporate ownership. Industrial firms joined forces, merging into much larger enterprises. The merged companies often controlled up to, or even over, 70% of their industries. Ownership consisted of large number shareholders, with the shares sold on stock exchanges. Management took effective control of the firm, recasting the role of the shareholder to a relatively passive investor.[1] The new form of organization, corporate capitalism, created a new

1 Martin Sklar, *The Corporate Reconstruction of American Capitalism, 1890-1916* (New York:

relationship of the worker to his employer. It thus also prefigured a transformation in the relation of the citizenry to the state. The transformation was predicated on changes in the law.

Corporate capitalism required a new set of legal rights. Existing scholarship claims these rights were constructed via judicial interpretation of antitrust law. Yet there were two ways to control the corporation: via antitrust regulation or via state incorporation law. The second was arguably the stronger of the two.[2] Further, in America corporations are chartered in the states, and not by the federal government. Federalism shaped corporate capitalism. Legislatures in the states constructed the various attributes of the business corporation. They did so both in response to the needs of their local economy, but also to the pressures and innovations of other states.

The construction of American corporate capitalism has great significance for economic and industrial development more generally. British corporation law up to 1860 was the most advanced in the world. Great Britain was the first nation to industrialize, and her corporation law deeply influenced American corporation law and corporate practice. Following the Civil War, America industrialized, and American corporation law changed, gaining ascendancy by the century's end. American corporations, and corporation law, stood at the leading edge of economic development. The innovations in both were essential elements of American system of corporate

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Cambridge University Press, 1988). Naomi R. Lamoreaux, *The Great Merger Movement in American Business, 1895-1904* (New York: Cambridge University Press), 18.

2 See Naomi R. Lamoreaux, *The Great Merger Movement in American Business, 1895-1904* (New York: Cambridge University Press, 1985), 162; and Charles W. McCurdy, "The *Knight* Sugar Decision of 1895 and the Modernization of American Corporation Law, 1869-1903", *Business History Review*, 53:3, (1979).

capitalism.

Despite its obvious importance, statutory corporation law in the late nineteenth century has been understudied and underappreciated. Corporations are entities created in law. Their attributes and rights are hence political. The legal document creating the corporation is its charter; in the United States general business corporations are, and have always been chartered in the states. The state, in enacting a charter, exercises what in the abstract (at least) is one of its most awesome acts, the creation of something out of nothing. By declaration an association of persons is granted the corporate right to form a body politic, distinct from the right of any one individual (and also distinct from a partnership.) Without the state, there can be no corporation.

Most studies on the development of corporate capitalism focus on national-level antitrust regulation and enforcement. The Federal Government only began to attempt antitrust regulation in the 1890's, and even then the Supreme Court severely restricted Congressional action. However, the states adjusted virtually all attributes of corporate existence in the period of this study. This included the extent of limited liability for shareholders, the right to pursue business objectives for any legal purpose, and the right to own any amount of real estate. States granted corporations the right to purchase the stock of other corporations, and to merge. They removed limits on capitalization and granted innovative forms of ownership organization, such as the multiple classes of stock.

While existing theories attribute the appearance of liberal corporation laws to social efficiency or private power, I suggest that the legal basis of corporations was heavily influenced by the dynamics of American federalism, and that we must look at the profile of economic activity within each state in order to explain the legal development of corporation law. The American states varied in terms of types of economic activity and level of industrialization. States responded to the economic needs within their state, to developments in other states, and to efforts by firms to build national market systems. States with high degrees of capital concentration in manufacturing were more amenable to liberal incorporation law than states with widespread small-scale manufacturing. This deep rooted practice of adjusting corporate rights in an individualistic legal system is indicative of an American tradition of corporate rights. Deep and prolonged state innovations of corporate rights resulted in an "American System" of corporate capitalism. Federalism in 19th century America shaped corporate capitalism of the 20th century world.

The construction of corporate capitalism has broad significance. With the rise of corporate capitalism, the relation of the worker to the economy changed. This involved not merely the replacement of skilled crafts with unskilled labor in mass production, but also the creation of a middle class and a stratified business class. All would have a new relation to the economic system, and thus also to the state. As Martin Sklar notes, the construction of corporate capitalism was also the construction of a new ideology.[3]

Karl Marx's theory of historical development was predicated on class struggle at defined stages of economic development as the central motor of historical change.

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[3] Sklar, Corporate Reconstruction, 4-9.

A central insight of his was that consciousness is determined by one's relationship to the means of production.[4] Preferences are formed by individual's means of garnering their livelihood. This element of his theoretical structure both preceded his analysis, and survived scholarly evisceration of much of his theory. For those more inclined to mainstream American thinkers, James Madison made the same point in Federalist 10. "The latent causes of faction" Madison suggests, "are thus sown into the nature of man."

> Those who hold and those who are without property have ever formed distinct interests in society. Those who are creditors, and those who are debtors, fall under a like discrimination. A landed interest, a manufacturing interest, a mercantile interest, a moneyed interest, with many lesser interests, grow up of necessity in civilized nations, and divide them into different classes, actuated by different sentiments and views.[5]

Madison's concern with faction is built upon an astute observation about preference formation. One's relation to the economic system determines ones preferences. Despite this insight, Madison (unlike Hamilton) was not an apostle of industrial development. He was not enamored with proprietary capitalism, and could not have foreseen the rise of corporate capitalism. He thus was not in a position to evaluate the changing relationship of American laborers, employers, and middle level managers to the means of production, and thus to the state. As these classes of persons grew, they

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[4] In The German Ideology, Marx argues that the ruling ideas are the ideas of the ruling class, and that the ruling idea in a feudal society are duty and obligation, while the ruling ideas of capitalism are freedom and equality. These ideas are held irrespective of class position, as if within each system the ideas are universal and transcendent. In the Manifesto of the Communist Party, he more actively ties interests to class position. Karl Marx, *Selected Writings* (Lawrence H. Simon, ed.) (Indianapolis, IN: Hackett Publishing, 1994). For treatments of Marx's theory of historical materialism see William H. Shaw, Marx's Theory of History (Stanford, CA: Stanford University Press, 1978) and G.A. Cohen, Karl Marx's Theory of History: A Defense (Princeton: Princeton University Press, 1978).

[5] James Madison, Alexander Hamilton, John Jay, *The Federalist Papers* (New York: The Modern Library, 1938).

would impact preferences manifested in political preferences of the electorate. With the development of corporate capitalism, much else follows.

Corporate Rights and Economic Development

Economic development in industrializing 19th century America was predicated on the proprietary corporation. Corporate capitalism in 20th century America was predicated, for better and for worse, on large integrated corporation. The transformation from the first to the second impacted economic development more generally. However, existing theories of economic development do not address nor explain how and why the legal environment altered corporate rights. This is an essential task to the construction of a political economic theory of economic development. While this work I do not offer an alternative theory of development, I do suggest that a viable theory of development must account for changes in legal rights of economic actors.

That the modern corporation requires the sanction of the legal system challenges several tenets of neoclassical economy theory. Neoclassical theory views the market as natural, preferences as exogenous, and the state as external to markets. The neoclassical formulation inevitably subordinates the role of the state in establishing favorable economic conditions, and often relegates legitimate state action to designing remedies for externalities.

The classic theory of development is take-off theory. W. W. Rostow defines takeoff as the "increase in volume and productivity of investment in a society such that a sustained increase in *per capita* income results."[6] This can result from a sustained increase in yields as a result of technological advance, or from an increased propensity to invest. This requires that a society respond to an impetus (usually short lived) with a change in productive enterprise, encompassing "political, social, and institutional changes."[7] Although the conditions for take-off include political change, precisely what these changes are is underspecified in Rostow's analysis. He regards the 1850's as the key to takeoff in the United States, but in doing so underplays the importance of legal changes undergirding rapid development from the end of the Civil War to 1900. [8] Further, his treatment of developing nations as hermetically sealed from political and economic developments outside of the given nation's boundaries is untenable.

More recently, New Institutional Economics has sought to develop a general theory of economic change. Douglass C. North seeks to incorporate political and economic institutions, demographic change, technological change, and ideology into such a theory, while largely accepting the neoclassical postulate of utility maximization.[9] North argues that *the* essential ingredient for economic growth is that property rights be both clear and stable. Clear and stable property rights allow individual returns to more closely approximate social returns. The primary function of the state from this perspective is to specify and enforce individual property rights. A

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6 W. W. Rostow, *The Process of Economic Growth, 2nd ed.*, (New York: Norton, 1962), 103-4.

7 Ibid., 275.

8 The perspective I adopt here acknowledges the role of politics in the creation and regulation of markets. In that regard I am in sympathy with Karl Polanyi, who asserted that markets are constructed. Karl Polanyi, *The Great Transformation* (Boston: Beacon Press, 1957 [c. 1944]).

9 Douglass C. North, *Structure and Change in Economic Histor*y, (New York: W. W. Norton, 1981). In North's view, Marx's theory of historical materialism is merely a special case of North's more general theory.

state geared towards development can engender the stability of contracts with secure but low enforcement costs. An efficient property rights regime will thus reduce transaction costs and maximize economic performance.[10]

At the end of the day, beyond a vague injunction for the protection of private property, North does not tell us what the law should look like.[11] Just as important for our purposes, he does not address the constitutive powers of the state to create the corporation. North recognizes the efficiencies of managerial coordination of throughput, and also suggests that these have the effect of lowering transaction costs.[12] In his critique of neoclassical economics, North seems to regard monopolies as inherently inefficient. They are, in his view, necessary payoff by the ruler to potential adversaries for stability.[13] The role of the state in creating political entities, and their constituent rights is not discussed. He does not address which of these rights are most conducive to economic success.

In this regard North is aligned with Ronald H. Coase. Coase maintains that once clear and stable property rights are secured, the content of those rights will not affect the overall social product (although it will impact the allocation of resources).[14] I maintain that, when it comes to corporation law, this is not correct. Corporate rights are, among other things, a state-structured form of property rights. If we accept Alfred

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[10] Ibid., 7, 15-18.

[11] See, for example, Douglass C. North, *Structure and Change in Economic History* (New York: Norton, 1981); W. W. Rostow, *The Process of Economic Growth, 2nd ed.*, (New York: Norton, 1962).

[12] Ibid., 176.

[13] Ibid., 27.

[14] R. H. Coase, "The Problem of Social Cost," *The Journal of Law and Economics*, Vol. III, (Oct.) 1960: 1-44.

D. Chandler's argument that managerial coordination is more efficient than market transactions,[15] then the designation of property rights that promote centralized control will in fact affect overall social output.[16] The property rights designated via corporation law leads to an increase in overall social wealth. North rightly directs attention to the state, but underspecifies the importance of the content of the state policies.

The increase in overall social wealth is, of course, generally regarded as the s*ine qua non* of economic existence. The question of who can make a legitimate claim on that increase of wealth directly follows. Some individuals will have endowments position them to take greater advantage of the positive law that will others. This is not the entirely the result of a neutral market, but also a result of positive law.

Claims to the increase of wealth are typically made by incorporators and investors, the initiators of the business endeavors. Neoclassical theory asserts that rents belong to entrepreneurs and shareholders. This assertion is made with the implicit (or explicit) assumption that the state is and should be a neutral arbitrator of market relations. However, such assumptions are problematic when the state becomes enabler of rents. In enabling corporate existence the state is more than merely a

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15 Alfred D. Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, MA: Belknap Press, 1977.)

16 It is important that we distinguish the Coase Theorem from Coase's theory of the firm. The Theory of the Firm asserts that the firm will exist when it can reduce transaction costs relative to market transactions, while the Coase theorem states that with clear and stable property rights, social output will not be impacted by the content of those rights. Yet the Coase Theorem and the Theory of the Firm are part and parcel of the same approach; both derive from radical individual maximization in a world of market exchanges. Further, the critique of the Theorem implies a critique of the Theory of the Firm. Firms will derive advantages as a result of positive law: the law will make for the possibilities of selective advantages for some and not for others.

neutral arbiter of property relations. Rather, the state has a direct role in the increase of overall social wealth. Further, when it does so, it increases inequality. The corporation is, after all, a vehicle for the concentration of wealth.

States and The Corporation

Several disciplines study corporate development, including business history, sociology, legal studies, and studies of political development. They have varied significantly in their assessment of the role of the state in shaping the corporation. Thus they have also varied in their attention to the impact of the subnational states in developing corporate capitalism, and concomitantly in seeking to explain why the states changed their policies.

The most comprehensive study from business history is Alfred D. Chandler, Jr.'s *Visible Hand*. Chandler argues that at advanced levels of industrialization, the "visible hand" of managerial coordination is more efficient than the "invisible hand" of market transactions.[17] According to Chandler, the central dynamic of industrialization in the second half of the nineteenth century was the separate development of systems of production and distribution, and the joining of these systems in vertically integrated firms. This development followed the building of the transportation network, primarily railroads and telegraphs, from the 1830's to the 1880's. These provided the capability to transport agricultural and extracted natural

[17] I select Chandler because his is the most comprehensive account, he is clear in his scholarly commitments, and because, except for his treatment of the necessity of legal change, I find his account to be persuasive. Further, in constructing a standard for what is necessary *for* business, it is useful to seriously take into account the perspective *of* business. Chandler, *The Visible Hand.*

resources from the American West to cities in the East. The network created the possibility of a sure supply of raw materials to manufacturing firms. This allowed for an increase in throughput in conjunction with more efficient use of manufacturing plants, and the selling of branded products to a national market.

The large industrial business corporation combined mass production with mass distribution in a single firm. It rose via two methods: either vertical integration financed by internal growth that built purchasing and marketing networks, or by horizontal merger of individually owned firms (of course vertical or horizontal expansion could occur internally as well.) Vertical integration of the large industrial corporation involved managerial coordination of activities from material extraction though the final sale. Firms moved upstream into raw material procurement, and downstream into marketing. This integration occurred in industries that were able to introduce economies of scale and speed, particularly with continuous process manufacturing.

Almost absent from Chandler's analysis is a discussion of the law. It is the thesis of this work that changes in corporation law were an essential element to the transformation of the corporation, and thus corporate capitalism. In particular, changes in statutes at the state level were essential for the development of the American system.

An alternative approach, by William G. Roy, does by contrast emphasize the role of the state.[18] Roy emphasizes the importance of statutory law, but sees the state

[18] William G. Roy, *Socializing Capital: The Rise of the Large Industrial Corporation in America, (Princeton, NJ: Princeton University Press, 1997).*

as responsive to the demands made by business.[19] Thus he adopts a "power theory" based on class analysis, where the corporation controls the law. Drawing on Karl Polanyi, Roy argues that property relations are defined and enforced by the state. In his view, the rise of the large corporation involved a fundamental shift in the nature of corporate "rights, entitlements, and obligations." These favored a new corporate class over proprietary industrial owners. Capital was "socialized" and markets were constructed. In the United States this involved three basic changes. First, ownership became more liquid. Second, new capital and value was created by social agreement (capitalizing the promise of future earnings). Third, capital was mobilized from outside the original owners and promoters.[20] According to Roy the most important merger was the joining together of industrial capital with finance capital. European investment banks influenced the form of American investment banks; these in turn shaped the deployment of American industrial capital. The resulting state policies were shaped to meet these needs. Management was separated from ownership, and power was concentrated in the former. Many directors were responsible to (or were) investment bankers, and sat on boards of multiple firms.

Roy and Chandler point to New Jersey's change in law in 1889 as a transformational event. Roy asserts it instigated a "race to the bottom," whereby states lowered their standards to attract capital. But whereas Chandler nevertheless largely ignores the role of the state, Roy views the state as essentially derivative of the

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19 Ibid.

20 *Ibid.,* 248; The constructions of markets is derived from Karl Polanyi, *The Great Transformation*, (New York: Farrar & Rinehart, 1944).

business class. Chandler quite simply does not explain legal changes, while Roy explicitly treats changes in the law as an independent variable.[21]

Functionalist and power explanations of these type might seem like polar opposites, but here, at least, they do have one thing in common. Both focus on the demand for political outputs. However, they do not consider why a state legislature (and governor) might see fit to supply a preferred policy, or to resist. An explanation rooted in political contestation is called for.

There are important works by scholars of political economic history on the relation of the state to the economy, but not in the period under question. Thus there are significant studies of state policy before the Civil War, but surprisingly few investigations of state policy after the Civil War. In the 1940's the Social Science Research Council sponsored studies by Oscar and Many Flug Handlin on antebellum economic policy in Massachusetts, and by Louis Hartz in Pennsylvania. Each stressed deep state involvement (and investment) in economic development until the 1830's, followed by state withdrawal from infrastructure investment, and the rise of a *laissez faire* ideology.[22] More recently, several other works on antebellum state policy have follow this tradition.[23]

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21 Roy, *Socializing Capital*, 148.

22 Oscar Handlin and Mary Flug Handlin, *Commonwealth; A Study of the Role of Government in the American Economy: Massachusetts, 1774-1860* (New York: New York University Press, 1947); Louis Hartz, *Economic Policy and Democratic Thought: Pennsylvania 1776-1860*, (Cambridge: Harvard University Press, 1948). A third such study, on Virginia, appears not to have been published.

23 Ronald E. Seavoy, *Origins of the American Business Corporation, 1784-1855: Broadening the Concept of Public Service During Industrialization*, (Westport, CT: Greenwood Press, 1982); L. Ray Gunn, *The Decline of Authority: Public Economic Policy and Political Development in New York, 1800-1860*, (Ithaca: Cornell University Press, 1988); David A. Moss and Sarah Brennan, "Managing Money Risk in Antebellum New York: From Chartered Banking to Free Banking and

Legal historians have produced significant studies of national level corporation policy after the Civil War, but generally these downplay state statutory corporation law. Morton J. Horwitz places corporation law within a "crisis of legal orthodoxy," whereby classic notions of the corporation as an artificial entity gave way to a "natural entity theory."[24] Herbert Hovenkamp argues that corporation law depended on a classic political-economic ideology.[25] Martin Sklar argues that the success of the large corporation must be understood in terms of a transformation in social relations.[26] This transformation was a political result of conflict in the courts and in Congress over more than two decades. In all these cases, changes occur at the national level. J. Willard Hurst, in tracing the development of the legitimacy of the corporation as an entity, does point to the general trajectory of corporation law in the states. Yet he does not distinguish variation in state policies. He takes the trajectory of development corporation laws in the states as a unified whole that was functional and thus functionalist. The dynamics of federalism do not enter into his analysis.[27]

These dynamics must be integrated into a theory of economic development. The exercise by the state of the charter power was commonplace in the nineteenth

Beyond," *Studies in American Political Development* 15:2 (2001), 138-62.

24 Morton J. Horwitz, *The Transformation of American Law: The Crisis of Legal Orthodoxy, 1870-1960*, (New York: Oxford University Press, 1992).

25 Herbert Hovenkamp, *Enterprise and American Law, 1836-1937*, (Cambridge: Harvard University Press, 1991).

26 Martin Sklar, *Corporate Reconstruction.*

27 J Willard Hurst, *The Legitimacy of the Business Corporation in the Law of the United States, 1780-1970*, (Charlottesville: University of Virginia Press, 1970). Elsewhere Hurst does detail state action in Wisconsin regarding the development of the states timber industry, and timber policy. We can surmise from it that states must have varied in the legal provisions based on the industries within each state. However, Hurst does not more develop this idea further, and it does not inform *Legitimacy*. James Willard Hurst: *Law and Economic Growth: The Legal History of the Lumber Industry in Wisconsin, 1836-1915* (Cambridge, MA: Belknap Press, 1964). See also Charles W. McCurdy, "The *Knight* Sugar Decision," 304-342.

century. It was often used as a substitute for more direct state power. The variety of entities chartered can be distinguished based on degree of public character, and whether they were created for a profit. A first category includes cities, towns, villages, and other government entities. These are entities to which states granted a measure of sovereignty over a geographic area. A second category includes non-profit entities organizations. This included colleges and educational institutions, as well as such associations as Masonic lodges, gymnastic and athletic purposes, or societies for the prevention of cruelty to animals. Profit making entities can be usefully divided into those of a public character, those that required close regulation, and those that required less regulation. Public utilities, for water, sewer, gas lamp, and electrical purposes fit into the first of these categories. They provided essential local (municipal) services. States also had an interest in closely regulating other companies that were not quite so closely tied to the infrastructure. This included banks, savings and loans, and insurance companies (including life, fire, property, marine, and others). Profit making private entities that required less regulation included firms chartered to build bridges, roads, turnpikes, canals, railroads, or other transportation facilities, as well as other useful services such as cemetery associations. Logically distinct from these are firms that are not so closely affected with the public interest. The most important such category was for laws authorizing manufacturing and mining.

The public and private areas of charter law came from a common origin. Many states situated charter law for the various types of corporations, public and private, under the same title. For several states this persisted to the middle of the nineteenth century. Thus cities and villages were in the same title as railroads or manufacturing companies. Some general provisions applied alike to businesses as well as towns and villages. The trajectory of the liberalization of the industrial business corporation grew from this (these) category (categories). As the century progressed, states increasingly distinguished between types of corporations. This is reflected in the complexity of their codes, and most particularly in the promulgation of different titles and sections of the state code for the different types of entities.

States typically created sections of their code for corporations affected with the public interest before they wrote code for manufacturing companies. Innovations in the charter law thus were often set in the former areas before being implemented in the latter. For example, some states allowed non-competing railroad lines to merge before writing similar laws provisions for manufacturing firms. However, the manufacturing law was distinct, and would come to be the section of the code to govern most large industrial companies.

In order to explain the provision of incorporation law for manufacturing firms, I draw on a central insight from Catherine Boone's *Political Topographies of the African State.*[28] Boone argues that we must examine the preexisting structure of authority to explain colonial and post-colonial state administrative strategies. Most importantly, we must examine whether the preexisting administrative structure was hierarchical or decentralized, and whether class structures were relatively more stratified or horizontal. This runs counter to prior explanations that suggested that

[28] Catherine Boone, *Political Topographies of the African State: Territorial Authority and Institutional Choice*, (New York: Cambridge University Press, 2003).

French colonies would be set up with hierarchical administrative structures and British colonies would be set up with decentralized structures, or that structures were set up based on the ideology (often Marxist) of newly ascendant leaders. She shows areas that cut across political boundaries (part British, part French) but have the same administrative structure, and areas within one political boundary (all British or all French) where the administrative structure varies. She asserts that this can be explained by the profile of precolonial political authority. The key insight for my purposes is that we must look to the "conditions on the ground" (the political topography) to understand state strategies for administrative organization.

Although my concern is not administration, this logic is useful for analysis of late nineteenth century corporation laws. Rather than the structure of administration, we must look to the profile of industrial activity. Here, Martin Sklar's distinction between proprietary capitalism and corporate liberalism is useful. Sklar shows that from 1890 to 1916 small producers and large manufactures contested in the political area over the shape of an emergent corporate liberal ideology. The "Corporate Reconstruction of American Capitalism" was the transition from competitive capitalism featuring proprietarily owned firms to corporate capitalism featuring large integrated firms.[29] This transformation was not smooth, but the result of a political conflict in the courts and in Congress over more than two decades. The United States in the late nineteenth century is notable for the limited, mainly negative, role of the national government. Federal regulation of the economy was largely restricted to two

[29] Sklar, *Corporate Reconstruction.*

major acts, the Interstate Commerce Act of 1887, and the Sherman Act of 1890. The Interstate Commerce Act gave the federal government some powers for regulating railroad rates, power that was contested and extended over the following three decades.[30] The Sherman Act restricted combinations in restraint of trade, but was largely eviscerated by a series of Supreme Court decisions. The Supreme Court made sure that there would be strong impediments to federal regulation of corporations.[31] Sklar notes that small manufactures were more militantly opposed to exempting labor from the Sherman Act, a position that hardens after *Loewe v. Lawler* (1908) made secondary boycotts illegal.[32] He regards the evolution of the political battle as ultimately an accommodation of large and small manufactures, rather than strict opposition to one another.

Sklar's analysis concerns antitrust regulation at the federal level. This was a crucial area of regulation. However, before the federal government passed the Sherman Act, states sought to create and control corporations through statutory law. The states were the sites of parallel political battles over the place of the corporation in the American political economy.

States had different profiles of economic activity. Industry in a state can consist of large numbers of small producers that control the bulk of industrial output in a state, or it can be controlled by relatively few firms. This profile can take many

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30 Among the most important changes were the Elkins (anti-rebating) Act of 1903, the Hepburn Act of 1905, and the Mann-Elkins Act of 1910.

31 Arnold M. Paul, *Conservative Crisis and the Rule of Law: Attitudes of the Bar and Bench, 1887-1895*, (New York: Harper Torchbooks, 1969). See also Martin J. Sklar, *The Corporate Reconstruction of American Capitalism, 1890-1916 (New York: Cambridge, 1988).*

32 208 U. S. 274 (1908); Martin Sklar, *Corporate Reconstruction, 223-6, 228.*

shapes, but can be thought of as a continuum from broadly owned to relatively concentrated. The profile of economic ownership will determine the amenability of a state legislature to laws that will favor greater concentration. States with centralized industrial profiles were more likely to offer liberal charter laws. States with already developed and widespread small manufacturing economies, but an absence of large centralized firms, were less likely to liberalize their incorporation law. This is because the small producers would be threatened by concentrated economic power.[33]

The division of proprietary and large corporate interests impacted state laws. The states varied in their profile of economic development, and of ownership concentration. What matters is not merely the relative shape of the industrial sector, but also the degree of concentration relative to all economic activity in the state. States responded to the needs of economic actors within the profile of industrial activity in relation to the whole of economic activity within the state. This suggests that small agriculture can join with small manufacturing against laws that permit corporate consolidation. This explains why New York, for example, was reluctant to some liberalize many of its provisions restricting the size and scope of corporations. New York was home to over 2000 separate textile firms; sugar was the only major industry that was tightly held. Thus New York was not hospitable ground for wholesale charter liberalization. One argument about why New Jersey liberalized was that it was a small state near the center of the metropole.[34] Yet Connecticut was also a

[33] Accommodation is understandable in one important sense. Many small scale firms often obviously sought to become large. Thus their interests might merge over time with large industrial firms.

[34] Christopher Grandy, *New Jersey and the Fiscal Origins of Modern Corporation Law* (New York: Garland, 1993).

small state, and arguable roughly as convenient to downtown Manhattan. But the profile of Connecticut included well-developed small manufacturing. By contrast, New Jersey was characterized by more concentrated industries.

This suggests that alliances were formed outside of the otherwise most salient class and sectoral cleavages. Small agriculture combined with small scale manufacturing to oppose centralizing tendencies in their states. This is different from alignments that merely pit agriculture against industry. It also suggests that labor of small scale industries might oppose labor of large scale industries, and that labor of large scale firms might support laws dedicated to large scale industry. If so, we can expect to see political support fall on this axis rather than on a division between the business class and the working class.

I treat changes in the law as the dependent variable. This places the focus of inquiry directly on factors that induce a state to supply a desired (or undesired) policy. In this regard, at least, I am in agreement with J. Willard Hurst. He writes that "Corporation law has always been an instrument of wants and energies derived from sources outside the law; it has not been a prime mover. However, means can materially affect the content of ends to which they are put, and the kind of tools men can obtain may decide on the jobs they can do." Further, he suggests that "the kind of structure, procedures, and privileges which corporation law made available significantly channeled the expression of men's wants and energies and significantly affected the responses which other interests made to these drives."[35] However,

[35] Hurst, *Legitimacy of the Business Corporation*.

whereas Hurst favors functionalist explanations, I seek structural economic and political determinants of state policy, which themselves shape future actions. Although I treat corporation law here as a dependent variable, I do so at the same time with the larger cognizance that the law has tremendous impact as a mediating variable. It impacts the trajectory of business and economic organization, and thus ultimately also impacts the political process as well.

The Case For Federalism

The political economy of corporation law in America is rooted in federalism.[36] State policies had a profound impact on the political economic development of the nation. This, of course, is hardly new. V. O. Key Jr.'s seminal *Southern Politics in State and Nation* depicted individual state cultures that offered significant variations on the main theme.[37] Daniel J. Elazar argued that states have individual civil societies, and that administration of most policies is a non-centralized partnership that involves contestation and cooperation between the state and national units.[38] Elazar at the time was arguing against the dominant paradigms of his day, which subordinated the importance of federalism.

Despite these efforts, scholars of American political development have

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36 One can think of other some cultural issues where there may also be a significant impact, such as variation in state laws on abortion, or the current issue of gay marriage. In both such instances the policy of one state may impact the behavior of citizens in the other states, and influence the policies of the other states. Thus for example, the principle of comity may lead to the recognition of gay marriage by a state that otherwise opposes such marriage.

37 V. O. Key, Jr., *Southern Politics in State and Nation*, (New York: Vintage Books, 1949).

38 Daniel J. Elazar, *American Federalism: A View from the States*, (New York: Thomas A. Crowell, 1966). However, for an interesting collection of essays from major scholars of that time see Aaron B. Wildavsky, ed., *American Federalism in Perspective,* (Boston: Little, Brown, 1967).

continued the practice of treating the role of federalism as peripheral. Most of the best work concentrates on national level political contests. When the nation is disaggregated into parts, sectionalism in one form or another has been the preferred method of analysis.[39]

There are works in political development have recognized the importance of state policies. Thus Richard Bensel examines state party platforms, albeit in service of a sectional argument.[40] Skocpol draws our attention to the spread of state mothers pensions in the late Progressive Era as a precursor for the failure of national level policies in the 1920's, and thus setting the stage for the federal structure of the welfare programs constructed in the New Deal.[41] Walter Dean Burnham examines state election returns as constituent elements that are then aggregated into national level realigning elections.[42]

Constitutional scholarship has hardly been able to avoid federalism. Seminal cases such as *McCulloch v. Maryland (1819)*, *The Slaughterhouse Cases (1873)*, *Lochner v. New York (1905)*, *Hammer v. Dagenhart (1918)*, *Williamson v. Lee Optical (1955)*, and *New York v. U. S. (1992),*[43] span U. S. history, and have all dealt in one

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39 See for example a dynamic sectionalism (where the boundaries of the sections vary) in Richard Bensel, *Sectionalism and American Political Development, 1880-1980,* (Madison: University of Wisconsin Press, 1984); for a static sectionalism (where boundaries of sections do no vary) see Peter Trubowitz, *Defining the National Interest: Conflict and Change in American Foreign Policy*, (Chicago: University of Chicago Press, 1998).

40 Richard Bensel, *Political Economy of American Industrialization, 1877-1900*, (New York: Cambridge University Press, 2000).

41 Theda Skocpol, *Protecting Soldiers and Mothers: The Political Origins of Social Policy in the United States*, (Cambridge: Belknap Press, 1992).

42 Walter Dean Burnham, "The Changing Shape of the American Political Universe," *American Political Science Review*, (1965) 7-27; and also in *Critical Elections and the Mainsprings of American Politics*, (New York: W. W. Norton, 1970).

43 *McCulloch v. Maryland,* U.S. 316 (1819); *Slaughterhouse Cases,* 83 U.S. 36 (1873); *Lochner v. People of th State of New York,* 198 U.S. 45 (1905); *Hammer v. Dagenhart, 247 U.S. 251 (1918);*

way or another with both federalism and economic regulation. They recognize that, as Chief Justice Marshall noted in *McCulloch*, "the question respecting the extent of the powers actually granted, is perpetually arising, and will probably continue to arise, as long as our system shall exist."[44]

The dynamics of federalism can usefully be divided into two types. One is the division of authority between state and nation, and the second is the impact of variations in state policies on the other states. Both impacted corporation policy. The federal government is a limited government of assigned powers, and in those areas where it has power, it is supreme. The commerce clause of the United States Constitution grants the federal government power over economic regulations. And although there was a federal law chartering banks since the Civil War, there is still no similar law for general business corporations.

Federal regulation of the economy was largely restricted to two major acts, the Interstate Commerce Act of 1887, and the Sherman Act of 1890. The Interstate Commerce Act gave the federal government some powers for regulating railroad rates, power that was contested and extended over the following three decades.[45] The Sherman Act restricted combinations in restraint of trade. Although it still guides antitrust principles today, it was subject to contest and interpretation in the 1890's. Arnold Paul frames the *E.C. Knight case* as part of a conservative reaction to sectional

Williamson v. Lee Optical Co., 348 U.S. 483 (1955); *New York v. United State*s (91-543), 488 U.S. 1041 (1992).

44 *McCulloch*, at 404.

45 Among the most important changes were the Elkins (anti-rebating)Act of 1903, the Hepburn Act of 1905, and the Mann-Elkins Act of 1910.

stresses in the early 1890's.[46] Sklar traces in this decision willful judicial disregard of the common law concepts such as "restraint of trade," and "attempt to monopolize." The *Trans-Missouri* case limited antitrust actions both by the federal government, and also by the states[47]. There were two ways to control corporations, by regulation and by statutory incorporation law.[48] Although the common law interpretations were restored by 1911, the absence of the capacity for antitrust regulation gave space for the dynamics of federalism to play out in the area of state corporation law.[49]

The second dynamic of federalism is the impact of state policies on each other. When the states do have authority on economic policies these policies can transcend state boundaries, impacting the trajectory of development of the nation as a whole. In a vein similar to the "race to the bottom" in welfare policy, states that liberalized their charter law were more likely to attract charters. Part of this liberalization involved passing provisions for corporations with no operations within the state.

The federal judiciary did take cognizance of the sovereign status of the states. Charles McCurdy suggests that the true reason for the *E. C. Knight* decision was to preserve state capacities in terms of state corporation law.[50] McCurdy also notes that state control over corporations was waning by this time. Intending to preserve state powers, the Court preserved space for state dynamics whereby states lost charter activity if they did not liberalize their law.

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46 Arnold M. Paul, *Conservative Crisis and the Rule of Law: Attitudes of the Bar and Bench, 1887-1895*, (New York: Harper Torchbooks, 1969).

47 *United States v. Trans-Missouri Freight Association*, 166 U.S 290 (1896).

48 Lamoreaux, *The Great Merger Movement*.

49 Sklar, *Corporate Reconstruction*, 117-154, especially 124.

50 Charles W. McCurdy, "The Knight Decision of 1895 and the Modernization of American Corporation Law, 1869-1903," *Business History Review*, 53:3 (1979: Autumn), 304-342.

Both the vertical and the horizontal dynamics of federalism impacted the development of corporation law. Nearly every state relaxed their incorporation laws over the thirty-five years following the Civil War. As the states relaxed their laws, they ceded more power to corporate entities, and allowed them to concentrate wealth to a greater degree than previously encountered. The concentration of wealth translated into further political power. The result was that state policies impacted the policies of other states, and thus also the trajectory of development of the national political economy.

Richard Bensel argues that building a national market was the most essential policy of the system of 1896.[51] He positions the Supreme Court as protector of this policy. Thus the Supreme Court guaranteed space for national corporations to dominate markets. As the corporate entities expanded beyond state boundaries, state control over those entities lessened. The Republican congresses saw little need to step into the void left by the states. Martin Sklar highlights the limit of a federal corporation policy, even as late as the final year of Theodore Roosevelt's administration, when a trial balloon for a national law for chartering corporations failed.[52] The interstice between state and national action created space for corporate consolidation.

The dynamics of federalism impacted the dynamics of national economic development in a broader sense. Walter Dean Burnham suggests that the realignment

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[51] Bensel, *Political Economy of American Industrialization*.

[52] Sklar, *Corporate Reconstruction*. Note that national charters for Banks date from the Civil War. Bray Hammond, *Sovereignty and an Empty Purse: Banks and Politics in the Civil War* (Princeton University Press, 1970).

of the 1890's was a battle of the metropole against the periphery. He argues that when capitalism and democracy came into conflict, capitalism won.[53] To this I would add that the structure of federalism contributed to this process, not merely by providing multiple venues for the development of incorporation law, and not merely by providing for the opportunity for a "race to the bottom." It provided a variety of subnational economies with distinct industrial profiles. This variation provided different forums that would be more amenable or less amenable to the changes that corporate actors desired. State corporation policies impacted the building of the national market.

The late nineteenth is often considered to be *the* quintessential era of *laissez faire.* This is ironic in the area of corporation law, as the policies actually emphasized the limits of a true *laissez faire*. Of course corporation law is not alone in this regard. The malleability of economic theory to the needs of economic actors belies a simple deductive economic logic. Champions of free markets advocated the tariff to promote internal development. A pyramid reserve system funneled money away from the periphery, and towards New York banks. The monies were then invested in the overbuilding of railroads. As Gerald Berk notes, the judiciary insisted on favoring management over the rights of bondholders in order to keep a national system together.[54] The northern states imposed punitive railroad rates on the South. And of course, state restrictions on opportunities for newly freed former slaves also belied the

[53] Walter Dean Burnham, *Critical Elections and the Mainsprings of American Politics.* New York: W. W. Norton, 1970.

[54] Gerald Berk, *Alternative Tracks: The Constitution of American Industrial Order*, 1865-1917, (Baltimore: Johns Hopkins, 1994).

notion that the economy was “free”.[55] State incorporation law is one of many policies by which the economy was shaped, and it provides a context for a more complete understanding of state action in economic development.

A democratic form of government presents the problem of mediating popular and monied interests. Burnham notes that the initial stages of industrial development have been a brutal and exploitative process that requires some form of insulation from popular pressures. Bensel argues that in the United States in the late 19th century, the Supreme Court performed this function. As the most insulated branch of the federal government, it defended national market construction from popular pressures.[56] In addition to this, however, I argue that the structure of federalism also facilitated the creation of corporate capitalism, and thus the building of a national market. State corporation law provided structural ballast in insulating corporate development from mass redistributionist tendencies.

Plan of the Dissertation

States in the nineteenth century were deeply involved in economic regulation via statutory law. The transformation of these laws was essential to the development of corporate capitalism. To make this case, the dissertation proceeds as follows. In Chapter Two I seek to clearly specify relevant areas of incorporation law that are

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[55] C. Vann Woodward. *Origins of the New South, 1877-1913,* (Baton Rouge: Louisiana State University Press, 1971).

[56] Walter Dean Burnham, “The Changing Shape of the American Political Universe,” *American Political Science Review*, 59 (1965), 24; Bensel, *Political Economy of American Industrialization*, 3.

necessary for advanced stages of industrialization. To do this I examine Alfred Chandler's *Visible Hand*. Chandler provides a comprehensive narrative of the development of the large corporation from the perspective of business. Although Chandler downplays the role of the state, from his narrative we can identify areas of the law conducive to corporate growth. I then assess the arguments of some of Chandler's critics. In their classic 1932 study *The Modern Corporation and Private Property* Adolf Berle and Gardiner Means identified legal elements that served to strengthen the hand of management vis-a-vis shareholders.[57] I draw on all of this to create a taxonomy of legal provisions for the corporation that are conducive to industrial advancement.

In Chapter Three I classify the corporation laws of 35 states over 35 years according to the standard developed in Chapter Two. These were the states in the Union at the end of the Civil War. The war's end signaled an economic expansion and a rapid increase in industrialization in the American Metropole. By 1900, many national market systems had been put in place, and business corporation law had assumed a modern form.

The comprehensive study of corporation law during this period reveals deep and active state regulation of their political economies via statutory law. States regulated corporations by limiting the purposes for which they could be organized, the term of existence, and other elements that constituted the corporation as an entity. They regulated modes of internal governance of the corporations, the extent of liability

[57] Adolf A. Berle, Jr., and Gardiner C. Means, *The Modern Corporation and Private Property*, (New York: Macmillan, 1937).

for shareholders and directors, and the legal right of corporations to combine with other corporations.

States in the Northeast had more developed corporation law than elsewhere, but even Southern and Western states granted corporation rights. New Jersey has been regarded as the leader of liberal corporation law. In contrast to the received literature, I show that New Jersey did not create new provisions for corporations, but rather assembled her liberal law from elements already in existence. A statistical analysis indicates that states with high ratios of concentrated capital were more likely to relax their corporation law, thus supporting my capital concentration thesis.

An analysis of the statutes tells us what the states did, but does not tell us why they did so. Chapters Five and Six are case studies of legislative arguments regarding corporation law. To prepare the way for these, Chapter Four examines the development of corporate doctrine. The American legal system is founded on individual rights. Since corporations are not individuals, granting rights to corporations presents difficulties. The problem is whether the corporation itself has rights, or whether its rights must be reduced to the individuals that compose it. Each approach presented problems. Treating the corporation as an entity in itself gives the corporation rights that individuals do not have. Reducing the corporation to the individual owners presented, among other things, problems of assigning liability. It also did not seem applicable when managers controlled corporations, as they began to do late in the century. At the end of the century a “natural entity” theory was advocated that sought to overcome these difficulties. Legal scholars have traced and debated the prominence of these theories during the period of this study. However, they have not examined the influence of legal doctrine on statutory construction. I outline the content and development of these theories for use in the chapters that follow.

This analysis of corporation theory in the states forces us to consider the place of the corporation in American politics. Louis Hartz has argued that American politics has been dominated by a liberalism based on individualism, while Rogers Smith argues that there are multiple traditions of hierarchy and ascription that subordinate individuals in out of favor groups. I argue that there is also a corporate tradition of formalized group rights that exists alongside the tradition of individual rights. The advocates of the corporate tradition are the lawyers of the businessmen.

Chapter Five examines the promulgation and justification of policies in state constitutional conventions. There are few places were detailed arguments of legislators are recorded. Most states did not record their legislative proceedings. There is also a limited record of legislative proceedings in newspapers beyond the mere fact of bill passage, especially before 1888. Fortunately, corporation provisions were put in state constitutions. A number of states held constitutional conventions where the corporation question was debated, often heatedly. In many cases the debates and proceedings were recorded by stenographer, and this provides a rare look into the arguments for a variety of corporation law provisions.

In the debates delegates sought to balance state control over the corporation with a desire to develop the state economy. Delegates justified regulatory efforts with arguments that treated the corporation as an artificial entity. Because the state created corporate rights, they argued, it could adjust those attributes as it saw fit. Yet the impact of industrialization was challenging the received conceptions of the law. Morton Horwitz contends that jurists and legal scholars confronted a crisis of orthodox conceptions of the law, in such areas as property rights, torts, the private/public distinction, and agency. Corporations were at the center of many of these issues. I argue that delegates at the state constitution conventions confronted the same pressures. In the context of the crisis of legal orthodoxy, and with the building of a national market, state liberalization of corporation law led to the decline of state capacities to regulate their local political economies.

A key element of this research is to identify occasions (if any) where corporations reached a "ceiling" as regards corporation law, and to examine how the state responded. Chapter 6 addresses one aspect of this. The New York State legislature investigated corporate abuses on four occasions from 1888 to 1897. The debates and proceedings were recorded. New York was often an innovator in corporation, was home to the financial markets, but also was predominantly agricultural with small scale manufacturing. While the analysis of constitutional conventions in Chapter Five addresses many key corporation issues, it does not address the issues of consolidation. In the New York investigations, by contrast, consolidation was a major issue, and many legislators sought to limit corporate efforts to consolidate industries. Yet the arguments in New York parallel the arguments of Chapter Five. Legislators were challenged by the crisis of legal orthodoxy, and found themselves increasingly unable to regulate the state economy via statutory law.

The decline in state capacities was an essential element of building a national market. Yet the state legislatures were the branch of government least insulated from popular pressures. They were answerable to pressures from their polities, unlike the Supreme Court, which Bensel rightly argues was entrusted with building a national market. Ironically, it was the multiplicity of these least insulated political institutions that developed legal rules essential for corporate capitalism. The development of corporate capitalism depended on developments in the states. Pressures in a federalist setting shaped state policies.

Concluding Remarks

Corporate capitalism developed in state statutes and in case law. The charter power was a tool for that state's used to control their economies. This power could be used to channel economic activity in ways that the states found advantageous. The results are manifest in the variation of corporation law in the several states. Corporate law thus was dependent on the political process and economic profile of industrial activity in each state.

The transformation of charter law in the late nineteenth century prefigured a loss of state power. The great irony is that as the states liberalized their charter law, they lost some control over the direction of economic development within their state. Eventually the states would compete for corporations charters. As corporations grew in size and in scope, the decisions of the states would impact the economies of not only each state, but also national and international economic development. Yet, as the states' charter power weakened, the federal government's actions were restricted by the narrow reading of Sherman Act (1890) via its relative evisceration by the Supreme Court in *E. C. Knight* (1895). This created space for more liberal corporate development that facilitated the concentration of capital in a few hands. The bureaucratic regulatory capacities of the federal government in the early twentieth century was built upon the incapacity of the states to regulate their economies via incorporation law.

Chapter 2

A Standard of Evaluation

This chapter constructs a legal standard for corporate development. I examine how Alfred Chandler, in *The Visible Hand*, defines the organizational needs and functions of business corporations. Chandler provides a comprehensive and sympathetic interpretation of corporate growth and integration from a functionalist perspective. My purpose in harnessing Chandler is two-fold. First, I argue that the legal basis for corporate organization cannot be ignored. Chandler's position subordinating the importance of the law is thus untenable. This, of course, is a common critique of Chandler.[1] Second, nevertheless a close reading of Chandler reveals key instances where legal structures are necessary in order for the large corporation to succeed. Although Chandler downplays the importance of legal developments, we can nevertheless identify those areas of the law that influence corporate growth and consolidation. Thus we can identify what might be termed the "ideal" legal conditions for corporate development. From this I define six categories of legal imperatives useful for evaluating the conduciveness of state law to the accommodation of the large industrial corporation.

There are, however, areas of law that do not appear in Chandler's narrative,

[1] See for example, Richard Franklin Bensel, *The Political Economy of American Industrialization, 1877-1900*, (New York: Cambridge University Press, 2000), 6-8; William G. Roy, *Socializing Capital: The Rise of the Large Industrial Corporation in America*, (Princeton, N.J.: Princeton University Press, 1997), 6-10; Neil Fligstein, *The Transformation of Corporate Control*, (Cambridge: Harvard University Press, 1977).

precisely because he downplays legal change. Therefore I examine the arguments of three of Chandler's critics on the legal basis of corporation law. Then, I examine Adolf Berle and Gardiner Means' *The Modern Corporation* in order to identify laws that place power in boards of directors. From these critiques I derive three additional categories that are not captured by my analysis of Chandler. These categories delineate the areas of the law that constitute the object of analysis in Chapter 3.

The Chandlerian Standard

Alfred D. Chandler Jr. strides atop the field of business history. *The Visible Hand* has come to be regarded as the dominant explanation of the success of the large business organization.[2] In this work Chandler accounts for the organizational imperatives for business firm success in an initial stage of rapid industrialization. The key actors in this narrative are business managers coordinating activities both at upper levels and middle levels of the organization.

Chandler argues that when a high volume of economic activity was reached in the late 19th century, administrative coordination permitted greater productivity than possible by market mechanisms alone. With advances in transportation and communication came the possibility of mass markets. Managerial coordination was better able to exploit the new opportunities than were independent operators relying on market transactions. In the process the owner-operator gave way to technically proficient managers. This typically involved the separation of ownership from

[2] Alfred D. Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business*, (Cambridge: Belknap Press, 1977).

management. It also involved the division of responsibilities into middle level management, which coordinated internal activities, and top management, responsible for strategic planning. These divisions lead to increased managerial specialization.

"Markets and technology" Chandler argues "determined whether the manufacturer or the marketer did the coordinating. They had a far greater influence in determining size and concentration in American industry than did the quality of entrepreneurship, the availability of capital, or public policy" (373).

> Legal reasons were, however, of much less importance than business reasons in bringing administrative centralization. Whether the motive for forming legal consolidations had been to maintain and strengthen cartels or to profit financially from the process of merger, mergers quickly found themselves in financial difficulties if they merely remained holding companies. The depression of the 1890's had demonstrated how hard it was for a number of small, single-unit enterprises operating under a single legal roof to become viable business enterprises unless they were centrally controlled (334).

Thus market and technological factors determined whether an industry would successfully consolidate or not. The determining factor was whether managerial coordination lowered production and distribution costs. This coordination is the essential element to achieve efficiencies not possible in market transactions. Thus the large corporation is a necessary vehicle for achieving economies of scale. According to Chandler, it is best to leave corporations free to experiment with various forms of organization, searching for that which is most amenable to long-term growth.

Despite this emphasis on the market imperative, there are several passages where Chandler acknowledges the role of the state. Some of these actions he addresses directly, others merely in passing. The areas were the state action impacted corporate growth in his narrative includes legislative grants, attempts at market coordination, state standards, antitrust regulation, and the impact of patents and tariffs.

Legislative Grants. Chandler does recognize how the selectivity of legislative grants did shape the market. He notes, for example, that legislative action in Pennsylvania granted the Pennsylvania Railroad a charter for a subsidiary, the Pennsylvania Company, which allowed the railroad to act as a holding company (155). From this the Pennsylvania Railroad developed a decentralized management structure. In 1871 Pennsylvania issued a catchall special charter to use in building Pennsylvania's railroad system that permitted holding stock in companies outside the state. John Rockefeller and his allies later purchased the charter to set up a company that consolidated oil pipelines (323). Particular charters of this sort indicated the possibilities of corporate consolidation, but would require liberal general laws to be a general practice (319). Chandler notes that New Jersey supplies the needed policy in 1889. However, he provides no explanation for why it did so.

Chandler clearly regards general laws for business incorporation as an improvement over special legislative acts (particularly when the state does not subsidize or subscribe to the business). If a special act were required, corporations would be subject to political forces. A state could act as a gateway that establishes significant barriers of entry to a market. This would likely hinder greater efficiency. Chandler argues that these political battles explain why Standard Oil did not seek a special charter and instead formed a trust (317).

Standard economic theory emphasizes the benefits of competition to the economy, and special legislative acts certainly restrict competition. We might expect Chandler to make this argument. However this is not the primary reason Chandler favors general laws. Large industrial firms seek to gain first-mover advantages, and thus the concomitant economic rents associated with that status. First movers then have the opportunity to act uncompetitively, using low cost advantages derived from economies of scale to threaten potential market entrants. Chandler has no problem with this. For Chandler it is the reduced reliance on legislative whim that privileges general laws over special legislative acts.

Market Coordination. Chandler notes the failure of attempts to coordinate market share. Trade associations that were formed in the 1870's and 1880's sought to coordinate output and price to prevent ruinous competition. These agreements were not illegal, but they also were not enforceable in courts of law. A party to an agreement was not engaged in criminal activity, but was also not able to use the government to hold other parties to their side of the agreement (316-7). Thus if a party to a contract exceeded his quota, others had no legal remedy to enforce the agreement. A similar dynamic occurred with pooling contracts. These were similar to trade association agreements, but between individual firms. The pool set output quota and price schedules, which members were expected to abide. Again, these were legal, but the courts would not enforce them. Chandler notes that in the 1870's railroads sought but failed to get federal legislation to make pooling contracts enforceable in courts of law (141). This led to the failure of then legal pools to set prices, not only in railroads, but also in manufacturing.

Chandler asserts that had the law sanctioned pooling contracts, cartels rather than integrated corporations would likely have been the dominant form of business organization in America, more approximating the practice prevalent in Great Britain. Had they been sanctioned, cartels might have tied themselves to the political system to thwart efforts of potential rivals, and in so doing entrenched existing businesses at the expense of creative destruction. The resulting cartelistic dominance would have retarded rapid industrial development by inhibiting managerial coordination. Outlawing cartels was essential in order to consolidate and rationalize industries dominated by large integrated firms. On no subject in the *Visible Hand* does Chandler so explicitly demonstrate the importance of legal standards.

Government Standards. The state also possesses the capacity to coordinate production and distribution. Although Chandler champions free markets, at times he does recognize the benefits of government coordination and oversight. For example, he approvingly notes that the Massachusetts legislature required banks to make regular reports to the Governor and Council as early as 1792. He also notes that early railroad charters included "close legislative oversight" (82).

State action sometimes facilitated or required industry-wide standards. Thus state railroad commissioners met in 1879 to "set up uniform accounting methods" (112). Later, the national government set up uniform accounting standards for the railroads in the Interstate Commerce Act of 1887. State regulation of grain elevators in the 1850's and 1860s "helped to standardize more precisely the grading and methods of inspection" (212). The Railway Safety Appliance Act of 1893 required air brakes and standardized automatic couplers on all railroad cars (130). Chandler sees these actions as beneficial. However, he emphasizes the coordination required among managers for these developments, while noting in passing the role of the state. Chandler does not theorize about when the state ought to intervene by providing industry standards. Nor does he distinguish, in these instances, the coordinating capacities of middle level managers from that of government bureaucrats.

Antitrust Regulation. Chandler notes that antitrust law did have a significant impact on corporate legal rights. The failure of pooling contracts provided an impetus for Standard Oil legal counsel S.C.T. Dodd to devise the "trust" in 1882. Individual companies were issued shares in a centralized board, which directed pricing and manufacturing policy. Operational management was maintained in each individual unit. Profits were sent to the central office, which redistributed these to trust certificate holders. This form of organization had a short life, although the name "trust" would remain in the lexicon. Chandler notes that the political winds did not favor cartels, although he does not explain why. In 1890 the Sherman Antitrust Act made trusts illegal.

Chandler argues that without the Sherman Act cartels of family firms "might well have continued into the twentieth century in the United States, as they did in Europe" (375). This parallels his arguments regarding pooling contracts. Cases such as *E.C. Knight*,[3] *Addyston Pipe,*[4] and *Trans-Missouri Freight Association*[5] upheld consolidations while proscribing loose combinations. These cases led to a vast expansion of investment banking as the drive to consolidate gained momentum (333). The *Northern Securities*[6] case slowed corporate consolidation by dissolving that particular holding company, although it did not make holding companies illegal *per se*. Rather, it induced corporations to eliminate constituent firms and consolidate into single companies rather than risk dissolution. Chandler's ultimate judgment is that antitrust legislation "reinforced technological and market imperatives" (375). It did so by facilitating the centralization of managerial control.

Patents and Tariffs. Chandler argues that patents were of greater import than tariffs in the success of the large industrial corporation, but downplays both. For example, he notes that a legal battle over patents slowed commercial production of sewing machines in the early 1850's (303). Patents protected American machinery makers, but were often ineffective in foreign markets. Chandler argues that continuous improvement of the product was often more effective as a strategy, particularly after the 1880's (374). Rather than rely on patent protection, it was more effective for companies to continuously improve production methods, which were in any case changing rapidly. His conclusion is that reliance on patents without a well-developed organization was not a viable business strategy (374-5).

Chandler argues that tariffs had minimal impact. He does acknowledge some

3 *United States v. E.C. Knight Co.,* 156 U.S. 1 (1895).
4 *Addyston Pipe and Steel Co. v. United States*, 175 U.S. 211 (1899).
5 *United States v. Trans-Missouri Freight Association* 166 U.S. 290 (1896).
6 *Northern Securities Corporation v. United States*, 193 U.S. 197 (1904).

exceptions, such as Francis Cabot Lowell's textile firm, a Boston Manufacturing Company which was aided by the Tariff of 1816 (59). Yet he downplays their significance when he argues that legal reasons were less important than business reasons for the success of the large corporation.(334). He also notes that the lack of government subsidies hurt American companies from competing in international trade shipping, though noting that congressional law reserved coastal and inland shipping to American companies (190-1). Nevertheless, he argues that foreign companies could avoid the tariff by investing in the United States.

The tariff has long been recognized as one of the most politically contentious issues of the late nineteenth century, with the major divisions falling along sectional lines.[7] C. Vann Woodward credits the tariff with drawing resources from South to North, by protecting domestic manufacturing goods, and inciting retaliatory tariffs that hurt southern cotton growers. The tariff funded a Civil War pension system that rewarded Union soldiers, but not former Confederates, even as the South paid its share of the cost.[8] Richard Bensel positions tariffs as one of three great political economic issues in the late nineteenth century (the others being the gold standard and building a national market). The tariff was battled out in the Congress, the least insulated of the three branches from popular political pressure. Although Bensel terms

[7] There are, of course, many sources for this, but for political-economic implications see Bensel, *Political Economy of American Industrialization;* and also C. Vann Woodward*, Origins of the New South, 1877-1913,* (Baton Rouge: Louisiana State University Press, 1951). Bensel considers the tariff to be one of three major policies of the Republican coalition effort at industrialization (the others being building a national market and the gold standard). However, he also claims that while it was essential politically, in terms of economics it was less important than the other two (512-518).

[8] Woodward, *Origins of the New South.* Theda Skocpol, *Protecting Soldiers and Mothers: The Political Origins of Social Policy in the United States* (Cambridge, MA.: Belknap Press, 1992)

the tariff the least essential of the three major policies (so that Congressional contestation did not so seriously threaten the political economic program as a whole), the contentiousness with which it was fought belies Chandler's assertion that it did not much matter.[9]

Public Pressure. The political process often involves public pressure, but this only rarely shows up in Chandler's narrative. When states did not provide wanted rules it is because public sentiment did not allow it. Thus when railroads petitioned Congress to make pooling contracts enforceable in courts of law, Congress resisted due to adverse public pressure (141), and as noted above, public sentiment did not favor cartel agreements to be enforceable in court. On the other hand, legislation to protect local retailers from wholesalers and department stores failed (237). And when corporations needed a statute to merge or act as holding companies, New Jersey quickly accommodated them (319). Chandler sees the first of these as rare, and the last of these as the normal circumstance. He provides no explanation for when and why public pressure will be successful.

Chandler does not systematically theorize about the appropriate extent of government regulation or settings of standards. In his view public policy did not have a significant impact on the character of the large industrial business organization. Rather, he argues that the revolution in transportation and communication led to the possibility of mass markets, which were best exploited by the systematic managerial coordination.

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9 Bensel, *Political Economy of American Industrialization.*

Chandler's theory of corporate development might seem compatible with Ronald Coase's theorem on property rights. The Coase theorem states that as long as clear and stable property rights are defined, individuals will maximize utility, resources will be put to their most productive uses, and social wealth will be maximized. Changing a liability rule, or other property right, may well allocate wealth in one direction or another, but the impact on overall social wealth will not change.[10] Thus it does not matter what the property rights are, so long as they are both clear and stable. This roughly comports with Douglass North's emphasis on clear and stable property rights. North emphasizes the importance of transaction costs, whereas Coase defines them out of this theory. Neither distinguishes between types of property rights that might be more or less conducive to rapid economic growth, although Coase is more explicit, and adamant, that the content of the law will not alter the overall social product.

Both Chandler and Coase treat the market as natural, and both recognize the importance of property rights. If we introduce legal imperatives to the Chandlerian process, however, these theories are no longer compatible. Chandler argues that the large corporation is more efficient than mere market transactions. According to him, property rights laws that encourage large industrial corporations thus allow for greater efficiency and a greater social product than laws that do not. The import of this is most apparent in *Scale and Scope.* There Chandler identifies legal rules regarding cartels and pools as the cause of differing trajectories of business development in

[10] R. H. Coase, "The Problem of Social Cost," *The Journal of Law and Economics*, Vol. III, (Oct.) 1960: 1-44.

Germany, England, and America. The acceptance of cartel contracts as legally enforceable in Great Britain retarded the development of the large industrial corporation.[11] If this is so, then it does matter what the law is: rapid industrial development is more likely under laws conducive to the Chandlerian process.

Legal Standards

This analysis above shows that Chandler's narrative does allude to legal problems and political conflicts. Yet, as Richard Bensel notes, Chandler downplays political developments, and under-theorizes the political problems involved in creating legal rules.[12] It is the thesis of this chapter that while Chandler plays down the importance of legal requirements, many of these elements can nevertheless be derived from his work. In the process the importance of these legal provisions to the developmental process is clarified. Despite this, there are some areas of the law that do not play a notable part in Chandler's narrative. These areas impact development. The purpose of this section is to identify these areas of the law.

Challenges to Chandler's thesis assert that efficiency fails as an explanation for why firms consolidated, and fails to explain why these same firms were able to succeed as large industrial entities. These take a variety of tacks, and I will review three examples here. Naomi Lamoreaux agrees that Chandler is right to point to market forces, but that he nevertheless misses a major dynamic impacting corporate

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[11] Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge: Belknap Press, 1990).
[12] Bensel, *Political Economy of American Industrialization*, 6-8.

consolidation. She distinguishes between firms in rapidly growing markets and those where market shares were relatively stable. Consolidations, she asserts, were more likely in industries with unstable, rapidly growing markets than in those with stable market shares. The horizontal consolidation movement of 1895-1904 was triggered by the economic depression of the 1890's. The poor economy led to real pain for firms, particularly for those growing, but unsettled industries. They consolidated in order to rationalize markets in the face of "ruinous" competition.

In a similar vein, Neil Fligstein argues that the merger movement was an attempt to gain "direct control" over markets. He asserts that overproduction rather than efficiency best explains this.[13] He demonstrates that the best predictor of whether a firm would merge with others in its industry was whether it had attempted earlier to form a cartel. Thus the motivation for merger was not economies of scale, but rather market control. This is supported by Lamoreaux's evidence that vertically integrated firms were not more likely to merge than other firms, and that firms in industries where market share was highly contested were more likely to merge than those in industries with stable market shares.[14] This also suggests that horizontal mergers were sought to gain market control.

A third, more direct critique, comes from William G. Roy. He argues that the rise of corporate capitalism is best explained better by a theory of power relations.[15]

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[13] Fligstein, *Transformation of Corporate Control*, 65-7.

[14] Naomi R. Lamoreaux, *The Great Merger Movement in American Business, 1895-1904*, (New York: Cambridge University Press, 1985), 90-94.

[15] William G. Roy, *Socializing Capital: The Rise of the Large Industrial Corporation in America*, (Princeton, NJ: Princeton University Press, 1997)

Property relations are defined and enforced by the state. In his view, the rise of the large corporation involved a fundamental shift in the nature of corporate "rights, entitlements, and obligations." These favored a new corporate class over proprietary industrial owners. Capital was "socialized" and markets were constructed. Ownership became more liquid, and capital was created by social agreement (capitalizing the promise of future earnings), often mobilized from beyond the original owners.[16] Using a statistical analysis, he finds that those corporations that consolidated and captured markets were not necessarily the most efficient.[17]

According to Roy the most important merger joined together industrial capital with finance capital. These newly adopted organizational forms were *isomorphic*: they resembled prior-existing forms. European investment banks, particularly those in England influenced the form of American investment banks. Industrial capital in America then copied these American investment banks. The resulting state policy was shaped to meet these needs. Management was separated from ownership, and power was concentrated in the former. This led to interlocking directorates. Many directors either were investment bankers, or were responsible to investment bankers.

All three theses challenge Chandler's reasons for corporate consolidation. Lamoreaux and Fligstein each argue for greater emphasis on a corporate desire for market control rather than for efficiencies of scale and throughput. Roy places greater emphasis on legal construction, and finds access to power as the reason for the

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16 Roy, *Socializing Capital*, 248; The constructions of markets is derived from Karl Polanyi, *The Great Transformation*, (New York: Farrar & Rinehart, 1944).

17 Roy, *Socializing Capital, 26-40.*

construction of corporate laws.

This is a fundamental disagreement. Consolidation of two or more corporations might have two distinct purposes: they could be formed to create greater efficiencies or they could be formed to eliminate competition. The first case corresponds to the Chandlerian ideal of greater efficiency, the second to a power theory of consolidation. Nevertheless, they usually work together, and we can identify areas of agreement as to which legal rules are most conducive to corporate success.

The areas of the law that deserve further elaboration include rules giving greater concentration of power in boards of directors, rules regarding combination, antitrust regulation, and limited liability. In what follows I examine these areas for legal rules conducive to corporate growth.[18]

Concentration of Power in the Board of Directors. In standard economic theory property rights adhere to owners. Yet, as Adolf Berle and Gardiner Means show in their classic study, *The Modern Corporation and Private Property,* ownership became separated from control in the late nineteenth century. Shareholders became more or less passive investors, and the board of directors gained control over firm operations. This thesis has been widely recognized since.

Measuring control of management vis-à-vis shareholders is not a precise science. Berle and Means detail a number of methods by which the board can gain

[18] Roy identifies three areas of law in his development in *Socializing Capital*. These are intercorporate stock ownership, the concentration of power in boards of directors, and limited liability. Roy, *Socializing Capital*, 149-154, 175.

power. This includes both legal means and extra-legal means.[19] Those that are accomplished by legal means were put into place via statutory law, by common law, or by a combination of both. Statutes often determined who had power to make major decisions affecting the finances of the corporation. Among these decisions are the ability to increase or decrease the corporation's amount of capital stock, the power to borrow money or issue bonds, and the power to make major transactions, including the purchase of another firm. The most restrictive laws required a formal change of the charter, with unanimous or a supermajority of shareholders to make the relevant decision. Giving the board a formal role, lowering the threshold of shareholder approval, or removing shareholder participation altogether tilted power into the hands of management.

Other statutory devices that shift power to management include the power to issue multiple classes of securities, the timing for issuing these same securities, and the discretion to buy back shares.[20] Multiple classes of stock provide an opportunity for management to shift money such that one class benefits at the expense of others. Another shareholder right Berle and Means identify is the preemptive right. If a corporation decides to issue new shares of stock, shareholders with the preemptive right may purchase that new issue in the same proportion as their existing holdings. This allows them to retain the same proportion of ownership as before the issue.

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[19] Adolf A. Berle, Jr., and Gardiner C. Means, *The Modern Corporation and Private Property*, (New York: Macmillan, 1937), 70.

[20] Ibid., 143, 160-61, 174, 191. There are additional powers that may accrue to management, including the power to control accounting (202), and to alter the original contract rights of securities holders (207). However, these advances occur after 1900, the period of study here.

States need not require a preemptive right, and those that weaken this right strengthen the hand of management.[21]

States allowed corporations to make contracts. In making some contracts, corporations made purchases. Some states allowed certain purchases to be made with corporate stock. The question then arose as to the value of the purchases, including who had authority to make the final determination. Roy has a measure of management's ability to value these purchases without input from the shareholders. He uses this as a proxy for a states' propensity to place more power in management. This is an important corporate right. However, it is only one. Part of my argument is that states adopted different strategies for regulating corporations. A narrow proxy such as Roy uses here may or may not accurately reflect the extent to which state statutes shifted power from the shareholders to management.

Berle and Means also discuss extra-legal means by which power can be shifted from ownership to management. These are outside the political process. The most important such shift in power resulted simply from the process of spreading ownership among large numbers of shareholders such that no one individual or even small group of individuals could own more than a fraction of a percent of the enterprise. In this case, if there is a majority of small stockholders situated similarly, the collective action problem will nonetheless render them unlikely to be able to combine their strength.

Berle and Means list five types of ownership structures. An individual might have complete ownership, in which they have full control; might have majority

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[21] Ibid., 145-6.

ownership, which will also result in complete control; or might use a legal devise without majority ownership that nevertheless provides full control. There can also be minority control, whereby a minority stockholder has a significant stake while all others have only a very small stake. This effectively gives control to the former. Finally, when ownership is sufficiently diffuse, so that no one shareholder has more than a very small percent ownership of the firm, then either a minority will be in control, or management control will be in control.[22] Obviously this will vary depending on particular dynamics of an individual firm. The point is that these variations in management ownership are not legislated, and are not developed in case law.

It is worth noting that the merger movement from 1895-1904 was characterized by such a change in ownership structure. Martin Sklar's term of proprietary capitalism reflects control by family firms and otherwise cohesive groups. Corporate capitalism reflects the ownership of large numbers of shareholders such that no single individual had control via stock holdings alone. The shift towards managerial specialization and control that Chandler celebrates resulted in part from this extra-legal dynamic, and in part from changes in the statutes.

The extra-legal means of corporate control presents a challenge for any study of management-shareholder relations. The question immediately arises, to what extent is management control via extra-legal means "natural"? The creation of the private corporation is a governmental act designed to enable private actors to organize capital.

[22] Ibid., 70.

Most states from the start had no limit on the maximum number of shareholders for a given firm, although some had limits on the minimum number. Early practice of most corporations was centralization around a proprietary firm. Investors put money in the firm based in part on the reputation of the management, which had a significant stakeholder share.[23]

The classical (and neoclassical) maximization postulate suggests that individuals seek to better their condition. New Institutional Economics suggests individuals in a given institutional setting will seek to further their interests within the constraint of the established institutions. I would simply note that as corporations transformed from proprietary firms into corporate capital firms listed on stock markets, the institutional structure needed to diffuse ownership was already in place. No further law needed to be passed; all that was necessary was greater size. It was, in essence, an unanticipated consequence of the institutional structure of corporate markets as they evolved in the late nineteenth century.

We might expect that extra-legal means as identified by Berle and Means were constant across the states. The extra-legal means of management functioned in any state which framed charter law to permit multiple owners (virtually all did). Thus any advantage a state had in attracting corporate capital would accrue based on the legal provisions discussed as discussed above. This would be convenient.

On closer reflection, however, it is not clear that this extra-legal means of

[23] For a discussion of this practice regarding banks, see Naomi Lamoreaux, *Insider Lending: Banks, Personal Connections, and Economic Development in Industrial New England*, (New York: Cambridge University Press, 1994).

centralization was truly independent of state law. Large size and the ability to combine operations via merger greatly increase the likelihood of large firms with large numbers of shareholders. State restrictions on size of capital would serve to restrict the capacity for extra-legal means of managerial control to materialize. A strict limitation of capital, if low enough, would not permit enough individual owners to have a share in the company. The ability to combine operations, whether via merger or inter-corporate stock ownership, permits firms to get much larger very quickly. Statutory law in these areas affects the impact of extra-legal means of corporate control within a state. Other restrictions, such as limitations on real estate, might have a more limited, but similar impact restricting large size.

It is likely, furthermore, that some states used specific policies to purposely place greater control in management. Eliminating the need for shareholder approval of major transactions is a likely example. Other policies that centralized management power probably did so unintentionally. Provisions that permitted firms to issue multiple classes of stock likely were intended to encourage capital formation, and not to give greater power to management. Similarly, states that allowed large size by raising capital limits or allowing mergers might well have intended to sanction large size without intending to centralize management control.

Managerial centralization encourages the Chandlerian process by facilitating strategic planning. Some elements of law are directed specifically towards this end, such as removing shareholder impediments to management actions. Others, such as permitting large size or mergers are also facilitative, though enacted for a purpose other than management centralization. Nevertheless, these size and combinations provisions work with the Chandlerian imperative, not against it.

Pooling and Cartels. The demise of cartels is a fulcrum point on which the rise of the large corporation turned. Recall that Chandler regards pools and cartels as a roadblock to efficient managerial coordination. In Roy's analysis, pools and cartels were not a response to the problem of internal organization to coordinate throughput, but rather an attempt to "rationalize" industries and to discipline markets. Earlier in the century local pooling was an accepted activity that reduced "ruinous" competition at the local level. Thus pools and cartels were not new; what was new was the effort to establish these on a national level.[24] Prohibition of pooling occurred when the state imposed a vision of what was "natural" vis-à-vis the markets.

Any contract results in at least a partial restraint on trade. In mid-nineteenth century common law tradition, general restraints on trade were forbidden but a partial restraint was legal. Although legal, these agreements were not enforceable in courts of law. Pooling agreements were in use after 1860, but it was only in the 1880's that pooling was considered to be a "general restraint on trade."[25] Although the judiciary refused to sanction contracts in restraint of trade, parties to these contracts were not subject to prosecution.[26] Freedom from prosecution in such instances, however, is not the key point for the Chandlerian process. What matters, rather, is enforceability in courts of law. Without that enforceability, a cartel will fail in its efforts to

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[24] Berle and Means, *The Modern Corporation.* 184.
[25] Herbert Hovenkamp*, Enterprise and American Law, 1836-1937, (Cambridge: Harvard University Press, 1991)*, 276-8.
[26] Lamoreaux, *The Great Merger Movement,* 162.

coordinate market activity.

Roy and Chandler disagree on the original purpose of pools, but agree in the effects of their prohibition. From the Chandlerian perspective, pools and cartels were an example of experimentation by entrepreneurs as business actors sought to rationalize production. I simply add that pools were evidently conducive to industrial development during the period they were used. But it is unlikely they would have been so at a more advanced level of industrialization.[27]

Combinations. The very essence of the corporation consolidation movement was the combination of capital via merger or by the formation of holding companies. We can usefully categorize combinations as trusts, holding companies, or mergers. The former allowed for the least leverage for management coordination, while the latter allowed for the most.

The trust was a "loose" combination. Stockholders traded in their stock certificates for each firm for trust certificates for the trust. The companies did not combine operations, but their output and pricing was directed from the central office. All sought in some form to prevent unreasonable restraints on trade, meaning market coordination of output or prices. As noted earlier, the first trust was formed by Standard Oil in 1882. Only a half dozen or so other trusts were formed during the ensuing eight years. Several states passes antitrust provisions in 1889, and the federal government passed the Sherman Antitrust Act in 1890. These made the trust form of

[27] Chandler makes this point more forcefully in *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge: Belknap Press, 1990). Here he shows that in Great Britain cartels were legal, and tended to dominate. Chandler credits Britain's relative decline in industrial success (compared to the United States and Germany) in large measure this cartelistic dominance.

organization illegal.

The holding company is a second type of combination. It is a corporation created to own other corporations. With a controlling interest, a company is able to direct its subordinate corporation's operations. Nevertheless, management in a holding company is less likely to be closely integrated as in a pure consolidation. The extent of corporate holdings other corporations may range from minority ownership to a controlling interest.

It is useful to distinguish between companies that can purchase corporate securities, and those that are formed solely to hold stocks in other companies. The former has a line of business as their primary object. Such firms may have an interest in vertical or horizontal holding of corporate securities. Vertical inter-corporate stockholding might allow a firm to secure a stable supply of raw materials by holding shares in a firm that supplies those materials. This is holding stock by moving "upstream" towards supply. Holding corporate stock of a railroad to insure product distribution is moving "downstream" into distribution.

The second type exists solely to control other firms. Technically, only these are true holding companies. In either case, the holding company may direct output and price, and might well include an upper management that directs corporate strategy, but this firm will not be able to coordinate throughput with the same degree of effectiveness as an outright merger.[28]

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[28] This definition of the holding company is consistent with that in chapter one of James C. Bonbright and Gardiner C. Means, *The Holding Company: Its Public Significance and its Regulation* (New York: McGraw-Hill, 1932). They, in addition to effective control of a company holding stock in other companies emphasize four features: centralized control, unified financing, pyramided stock

Bonbright and Means claim that the holding company as a means of control was not used significantly until after the *E.C. Knight* decision of 1895. Following the Northern Securities case, which dissolved that particular holding company, corporations became less likely to form holding companies and more likely to merge, as direct merger was seen as more legally secure.[29]

Both forms of holding company provide for the possibility of leverage, sometimes with multiple layers of management. For example, ownership of 50% of a subsidiary allows for full control over its operations (except for where a supermajority of stock is necessary for a decision). If that subsidiary company itself owns 50% of another company, then the original corporation can control the sub-subsidiary with only 25% ownership. Multiple tiering in this manner can thus provide for great leverage of control. From a Chandlerian point of view, while the holding company may allow for the coordination of price and output, it is less capable of coordinating details of production and distribution compared to a fully integrated company. On the other hand, it allows for greater flexibility in buying and selling assets. Thus it makes it easier to undo a faulty business decision compared to a merger.

A merger is the "tightest" form of combination: there the companies combine operations in an integrated whole. The late 1890's and early 1900's witnessed a "great

control and capital inflation. The first three I deal with. Capital inflation was the issuance of stock in excess of what the subordinate company could get away with, because the subordinate company was subject to restrictive regulations that a parent company might not be. While its motives are similar to stock watering (where stock is issued in excess of the value of the constituent parts of a combined corporation), in theory at least, there were assets backing the securities. Stock watering, however, was a significant issue in the late nineteenth century.

[29] Bonbright and Means, The Holding Company. See especially p. 66-72. The draw on data from Eliot Jones, *The Trust Problem in the United States*, (New York, 1928), esp. p. 40.

merger movement." From 1895-1904 some 1800 firms consolidated into about 200 much larger entities.[30] These companies had large numbers of shareholders, power concentrated in management, and listings on stock exchanges. The merger movement was possible only with a legal environment conducive to merger.

A variation on a straight merger is the asset transfer model, where corporate assets are bought by a "parent." Rather than a merger of equals it is the acquisition of the entirety of a corporation's assets by another. Functionally, the tightness of the operations depended on the management of the acquiring company. The acquiring company does not have to alter its management structure to make the acquisition as a result of the transaction. It becomes feasible in part if the acquiring corporation can issue some form of debt representing its new acquisition.[31]

Limited Liability. Limited liability was not a universal policy in the 19th century. This is probably not appreciated as widely as it should be. Horwitz notes that "truly limited shareholder liability was far from the norm in America even as late as 1900."[32] For example, New York experimented with double liability for banks in the first half of the century.[33] As a result of the variation in state policies, Hurst downplays the

30 Naomi Lamoreaux, *The Great Merger Movement in American Business, 1895-1904*.

31 See Hovenkamp, 255-7.

32 Horwitz, Morton J. Horwitz, *The Transformation of American Law, 1870-1960: The Crisis of Legal Orthodoxy* (New York: Oxford University Press, 1992), 94. By contrast Chandler barely mentions limited liability, and appears to consider it a natural constituent element of the corporate form of existence. See *The Visible Hand*, 36-7.

33 David A. Moss and Sarah Brennan, "Managing Money Risk in Antebellum New York: From Chartered Banking to Free Banking and Beyond," *Studies in American Political Development* 15:2 (2001), 138-62. See also L. Ray Gunn, *The Decline of Authority: Public Economic Policy and Political Development in New York, 1800-1860,* (Ithaca: Cornell University Press, 1988), 121, 227, 231-34, 236; and Ronald E. Seavoy, *The Origins of the American Business Corporation, 1784-1855: Broadening the Concept of Public Service During Industrialization*, (Westport, CT: Greenwood Press, 1982), 69-72, 190-2, 183-6, 192-4, 256-8.

importance of limited liability, emphasizing the pooling of resources under centralized control.[34] Early 19th century law conceived of the corporation as a trust fund for shareholders. This doctrine was applicable to a world where the corporation was an artificial entity entrusting to hold assets for the shareholders. Thus additional liability in certain circumstances made sense. The trust fund doctrine eroded in late in the century. Over time, in common law, shareholders began to be conceived as mere investors.[35] Limited liability was an essential element of this doctrinal transformation.

Roy measures state variation of limited liability by whether they have provisions for additional shareholder liability to be paid to mechanics and laborers.[36] Thus shareholders would be liable for monies owed over and above their contributions when, at dissolution, wages were due to the employees. Provisions such as these ought to have an impact on the Chandlerian process. Unlimited liability encourages shareholders to actively oversee the corporation, thus restricting management discretion.

Antitrust. The politics of antitrust is one area where the legal process cannot be missed, even by Chandler. Most such scholarly attention has focused on federal, as opposed to state, antitrust policy. Martin Sklar has demonstrated that the court declined to follow common law precedents that the act's authors might reasonably have expected to be applied by the court, given that the act borrowed language from the common law. The Supreme Court refused to recognize otherwise widely accepted

[34] J. Willard Hurst, *The Legitimacy of the Business Corporation,* (Charlottesville: University of Virginia Press, 1970), 25-6.
[35] Horwitz, *Transformation of American Law, 1870-1960*, 94.
[36] Roy, *Socializing Capital,* 175.

common law between reasonable and unreasonable restraints of trade. The *Trans-Missouri* (1897) case redefined the Sherman Act so that all combinations in restraint of trade were illegal, not merely those that were "unreasonable," in contrast to prior common law practice.[37] I accept Sklar's analysis as a point of departure for the analysis of state antitrust actions.

The corporate question arose in the states before it arose in the nation, and some states enacted antitrust policies before the Sherman Act of 1890. States had two means of controlling the corporation. The first was statutory corporation law, and the second was common law actions against restraints on trade.[38] The first was arguably the stronger lever of the two, because it creates the very possibility of corporate existence.[39] As late as the 1890's it was conceivable that states could control the corporation via statutory corporate law.[40] Statutory law relaxed limitations on size, mergers, intercorporate stock holding, and other means of consolidation or agreement between firms. This is the very subject of this dissertation.

Statutory law could cut across state lines. States' economies were impacted by firms chartered in other states. A state could combat this by placing restrictions on foreign corporations. However the ability of a state to restrict corporations from other

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37 Sklar, *Corporate Reconstruction*, 100-1, 127. See also Hans Thorelli, T*he Federal Antitrust Policy: Origination of an American Tradition*, (Baltimore: Johns Hopkins, 1955). *U.S. v. Trans-Missouri Freight Association* (166 U.S. 290).

38 Hovenkamp, *Enterprise and American Law*, 244-5.

39 Hovenkamp argues that corporation law was a poor device for selecting between harmful mergers that spawned monopoly or uncompetitive behavior, and those mergers that were efficient or economically beneficial. *Enterprise and American Law*, 266. By contrast Lamoreaux argues corporation law was a stronger tool than antitrust law. Lamoreaux, *The Great Merger Movement*, 162.

40 McCurdy, "The *Knight* Sugar Decision", 1-3.

states was limited by the practice of comity. By this principle, states accommodated foreign corporations on much the same footing as domestic corporations, with the expectation that the other state would similarly treat corporations chartered in its state. As some states liberalized their laws, corporations chartered under these liberal policies were positioned to capture markets in the more restrictive states. This tended to undermine statutory corporation law, the strongest state method of control.

After the 1890's states largely abandoned regulating objectionable antitrust activity via statutory law, although they would continue some prosecutions via common law restraints of trade.[41] Restraints of trade as a means of state control could be effective only if the provisions were enforced. The history of this enforcement, although significant, is beyond the scope of this dissertation. Suffice it to note that vigorous enforcement need not inhibit the Chandlerian imperative. Sklar details the Roosevelt and Taft Administration's in the vigor in instigating restraint of trade prosecutions. Sklar notes that Taft instigated twice as many such actions in under half the time as Roosevelt. Taft sought to follow common law understanding of unreasonable restraints of trade, prosecuted in the judicial arena.[42] Yet Taft was also amenable to large corporations. While restraint of trade prosecutions this might cause concern to individual businessmen, so long as the unacceptable activities were clearly demarcated, and still permitted consolidations and large size, then the Chandlerian

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41 Thorelli and McCurdy each argue states abandoned statutory policy with the turn of the century. Thorelli, T*he Federal Antitrust Policy*, 265, 596; McCurdy, "The *Knight* Sugar Decision", 304, 322; Hovenkamp, *Enterprise and American Law*, 244 n12. Hovenkamp argues that states continued with common law restraints of trade prosecutions even after this. Hovenkamp, *Enterprise and American Law*, 244-5.

42 See Chapter 5 in Sklar, *Corporate Reconstruction*, 333-82.

imperative could be met. This was the case under the Taft formulation.

The question regarding antitrust is whether it hinders or aids corporate development. Chandler argues that antitrust policy merely reinforced managerial imperatives. By this he appears to mean that antitrust policy furthered corporate consolidation that he argues would have taken place in any case. As Arnold Paul notes, however, the conservative judicial reaction in favor of corporate consolidation in the *E. C. Knight* decision was rooted in response to the threat of the populist uprising upsetting the established economic order.[43] This policy was by no means assured.

A Standard for Statutory Incorporation Law

Part of the Chandlerian process involved the capacity to experiment with different organization forms. This may involve a single firm's reversal from a failed organizational structure, or demise in the process of creative destruction. For Chandler the political ideal is a society-centered application of business incorporation law that promotes administrative coordination. Chandler's narrative downplays the role of politics as ancillary to the harnessing of economies of throughput and size. Nevertheless, Chandler's narrative still required that the political system adapt the corporate form to new imperatives of scale and scope. Without changes in legal rights, the large corporation would not have been possible. There would have been a greater likelihood of entrenchment of business forms with more limited coordinating

[43] Arnold Paul, *Conservative Crisis and the Rule of Law: Attitudes of the Bar and Bench, 1887-1895* (New York: Harpers Torchbooks, 1969).

capacities.

The above critique points to a variety of political factors that contributed to corporate development. Nevertheless, for the purposes of deriving standards for the purpose of fostering rapid economic development, they alter Chandler's standards only slightly. The following are the key principles that are conducive to efficiencies of scale and scope.

A. **Legislation should facilitate managerial specialization, including the separation of management from ownership.** Managerial coordination is necessary to harness economies of scale and scope. Laws that enhance managerial capacities are preferable to those that do not. Concentration of power in boards of directors leads to specialization of both middle and upper management. This allows "visible hand" coordination of purchasing, manufacturing throughput, and marketing. Policies that promote organizational forms that inhibit centralized coordination are not desirable.

B. **Laws should permit large size.** A large corporate size permits managerial coordination and concomitant economies of scale and scope. This can come from internal expansion, vertical integration or horizontal combination.

C. **Laws must be conducive to mergers.** Mergers that promote economies of scale and scope are beneficial. Not all mergers will accomplish this, but the market should weed out failures. Mergers directed towards short-term market control will be unlikely to develop coordinating capabilities needed to succeed in the long run.

Mergers with businesses outside one's core competencies are less important**.** Holding companies are less important because there is less likelihood of comprehensive managerial coordination.

D. General Laws are superior to special acts of the legislature. Laws that facilitate managerial coordination should not be reward charters based on favoritism. General laws are preferable to special acts of the legislature.

E. Legislation that promotes cartelistic behavior should be discouraged. Cartelistic behavior inhibits centralization of managerial coordination. In the absence of market sharing arrangements via cartels, consolidation is more likely, and thus there will be the possibility for centralized control.

F. Antitrust legislation should reinforce market imperatives. In practice this means that large horizontal and vertical mergers should be permitted. Antitrust policy should only discourage collusive price gouging. This means that firms that do not engage in predatory behavior should not be prosecuted, and also that firms should be free to experiment with different business strategies to harness the economies of scale and scope.

G. Expansion to related products. A corporation must be able to extend the range of their business to exploit related products and technologies in order to take full advantage of economies of scale and scope. This may take the form of vertical or horizontal expansion or vertical by horizontal or vertical integration.

H. Power in Boards of Directors. Central direction is facilitated by control in the board of directors. Statutory elements that contribute to this control include the power to value assets purchases with corporate stock, to value intangible assets, to issue multiple classes of stock, to buy back shares, to set the timing of dividends, to make major transactions without shareholder approval, and the weakening of preemptive shareholder rights.

I. **Limited Liability for Shareholders.** There should not be requirements on shareholders for extra liability.

By emphasizing the legal aspects of industrialization, I derive a most un-Chandlerian standard. Chandler emphasizes the replacement of market transactions with managerial coordination. Nevertheless, his position emphasizes the market as the driving force for corporate transformation. The standard here, rather, emphasizes the interaction of the firm, the political system, and the economy.

In crafting this evaluative standard from Chandler's narrative and from critical elaborations I seek to avoid normative evaluation. I accept that Chandler is largely correct that rapid industrial development is more likely with centralized control of oligopolistic corporations. Thus large corporate size might well facilitate the unequal accumulation of wealth, and it might well not be conducive to participation in civic life. Concentration of power in management might well be at once conducive to economic development and also unfair. As Burnham has noted, accumulation in the initial stages of industrialization has been a brutal process in many, if not all instances.[44] That does not mean the Chandlerian process does not facilitate more rapid

44 Walter Dean Burnham, "The Changing Shape of the American Political Universe", 59 *American Political Science Review*, (1965), 7-28, 24; see also comments by Bensel, *Political Economy of*

industrial development than would otherwise occur.

The ideal corporate structure may well include more significant restraints on management. This is a problem of precisely crafting management incentives so that they pursue Chandlerian goals. There is a tension between shareholder oversight of management to insure it makes decisions in the interest of the shareholders, and liberalizing corporation law so that management has freedom to make strategic and financial decisions with dispatch. Chandler does not provide a theory of the proper extent of government regulation. Such a theory might well have both an economic component of what policy best contributes to growth, as well as a normative component of equity.

American Industrialization, 3.

Chapter 3

Incorporation Law in the States

This chapter describes the broad contours of corporation law for manufacturing companies in 35 states from 1865-1900. I categorize statutory corporation law according to the standards developed in the preceding chapter, reorganizing them into four major areas. The first area involves the basic contours of corporate existence; these are *constitutive provisions*. This includes the establishment of general laws of incorporation, provisions for the range of legitimate corporate purposes, and limits on term of existence, on capital stock, and on property rights. The second area involves *internal corporate governance*. This includes placing power in boards of directors, the location of authority to make major financial decisions, and the ability to offer special classes of stock. The third area involves *limited liability* of shareholders and of directors. The fourth area involves the right to form *combinations.* This includes the power to merge, and to purchase stock of other corporations.

The division into these categories is somewhat artificial, in that the areas of corporation law overlap. Thus for example, a provision that extends corporate objects will impact an otherwise narrowly written general law. The ability to offer multiple classes of stock impacts the ability to alienate corporate property, yet also contributes to concentration of power in directors. However, this taxonomy tends to render the various provisions more intelligible than they would be otherwise.

States often wrote separate laws for different classes of organizations, one of which was manufacturing. Manufacturing firms can be distinguished from organizations formed for purposes such as insurance, railroads, canals, turnpikes, banking, savings and loans, or cemetery associations: manufacturing firms were not so directly affected with the public interest—they were not public utilities or transportation infrastructure.[1] It was the manufacturing laws that evolved into the general business incorporation law.[2]

The data for this study are drawn from the various revised statutes and consolidated codes from 35 states. These are the states that were in the Union at the end of the Civil War.[3] States during this period issued revised compilations of their laws typically every 10 to 20 years. Most were published by authority of the state, but in some states there were also private compilations. The quality of annotation for these books varied. Some publications clearly referenced the session laws and relevant court decisions; others merely reported the laws in force at the date of publication, making a precise genealogy difficult to ascertain. Where possible (and useful), I supplemented the statutory revisions with the state session laws.[4] A list of

1 The distinction of firms "affected with the public interest" was made in *Munn v. Illinois* (94 U. S. 113, 4 Otto 113 [1876]), where the Supreme Court ruled that states had the authority to regulate firms that "becomes clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large".

2 That is not to say that all innovations occurred first in the manufacturing law. Some provisions were first developed in regards to railroads. See Adolf A. Berle, Jr., [*Material For Studies Of The Legal Development Of Corporations In Various States*], (New York: s.n., 1932. These are unpublished notes on file at Columbia University Law Library.

3 I omit South Carolina due to lack of data. Excluded are territories existing at the end of the Civil War, although many of these became states during the period under study. These states, of course, were located in the West. As a rule, undeveloped states had fairly simple corporation laws, as did territories. It is notable then, that the aspect of sovereignty that rural yet growing territories exercised included corporation law.

4 I wish to thank Richard Bensel for providing me access to his private collection of revised statutes,

compilations I used for this study is provided in the Appendix.

I seek here to render the complexity of corporation law, even as I try to present summaries of state law in as simple a manner as possible. I present a number of tables making comparisons of state policies by section, constructed with 12 year intervals.[5] The dates of observation are 1865, 1876, 1888, and 1900. 1865 is the first year of this study, chosen because it marks the end of the Civil War, delineating a takeoff point for American industrialization. 1888 marks the first year of the New Jersey statutes: New Jersey at that time liberalized its laws to benefit a particular firm. Only in the next year would it more systematically examine and liberalize its charter law (more on this below). 1900 marks the end of this study. This is a somewhat arbitrary cut off point; one could argue just as well to continue the study up to 1914, the onset of World War I, and the end of the reforms of the Woodrow Wilson Administration. However, the merger movement occurred from 1895-1904; and most provisions allowing it to take place were themselves in place by 1900. 1876 is chosen as a mid-point between 1865 and 1888; it also distinguishes between reconstruction and post-reconstruction. Conveniently, each interval is 12 years.

Several observations follow from the data. The first has to do with patterns of development. Corporation law in the Northeast was more developed than in the South and West. Nevertheless, the South and West did have corporation law provisions, and

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which is many times more extensive than any library I am aware of. The Tarlton Law Library at the University of Texas at Austin has an excellent collection of session laws dating back to the founding. It holds complete collections for many states, although, regrettably, for other states the holdings are spotty.

5 I use the same sectional division used by Peter Trubowitz, *Defining the National Interest: Conflict and Change in American Foreign Policy*, (Chicago: University of Chicago Press, 1998).

several were amenable to the corporate capital, should it wish to employ resources there. Second, states used a variety of different provisions to restrain the corporation. We can see this in the variety of restrictions on corporate capital, on term of existence, on legitimate objects, and the like. Thus there was wide variation on corporate policy even within regions. Third, the states experimented with the different levers of organization. This resulted in different combinations of laws that gave power to the corporation, even as states sought to constrained that power. Were we to only look at one area of statutory law, we might incorrectly characterize the overall character of a state's corporation law. Rather, we must examine the overall character of the law to accurately depict state policy.

Fourth, there was a gradual relaxation of corporation law across the states. Were we to only look for say a ten or twenty year period in a few areas of corporation law, we would not see much change. Conversely, looking at a number of states across only one or two areas of corporation law also would not show much evidence of change. However, when we look at all of the states in a number of different areas of the law over a 35 year period of time, we see substantial change that seriously impacted the trajectory of corporate development.

Fifth, New Jersey has been regarded as the leader of the "race to the bottom," due to a significant liberalization from 1888-93. Yet virtually every provision of the New Jersey laws existed in somewhere else, typically at least 20 years earlier. The New Jersey innovation was in assembling already existing statutory provisions into a unified liberal policy. This development reflected an evolution in mindsets over appropriate corporate attributes. The New Jersey laws would have been inconceivable 20 years earlier.

Finally, the pattern of development of corporation law is humbling for those who wish a simple theory of corporate development. Because states pursued different strategies, we cannot look to only one or a few areas of corporation policy as indicators of liberalization. That there is a sectional pattern is unsurprising. However, it (obviously) does not explain regional variation. By contrast, the degree of capital concentration in the states does help explain the variation.

Characteristics of Major Corporate Rights
Constitutive Provisions

General Laws. A general law for corporations makes the acquisition of a charter a matter of right for any applicant that meets the established criteria. This right takes discretion away from legislatures, and in theory, out of the political process generally. However the attributes of general laws were delineated by legislatures.

At a minimum, all general laws grant a group of individuals the right to form an association and to become a body corporate. They grant the corporation the right to sue and be sued; to hold a capital stock; to engage in an economic activity (whether narrowly or broadly defined); to buy, own, hold, and convey property (with or without restrictions); to elect officers (with some specification on the mode of election); to call meetings; to make by-laws; and to use a common seal. The corporation typically also has obligations. These include the duty to elect officers in a timely manner; to meet capital requirements before commencing operations; to file certain records with the state or the county clerk; and to follow restrictions in the law.

Charters for business corporations in America date from the late eighteenth century.[6] Corporations at that time were chartered by special acts of the state legislatures. A classic example was the charter for the Charles River Bridge Company. That charter authorized that company to build a bridge between Boston and Cambridge, Massachusetts. The company then had the right to collect tolls for a specified number of years, which was later extended to 70 years.[7] This company was not allowed to pursue other objectives, or use its funds or resources for any other purpose.

Special legislative acts of incorporation would eventually be replaced by general laws. Corporate attributes and rights were made available to all applicants that met a preset criteria. The transition from special laws to general acts began in 1811, but did not take off until the 1840's. The authorization of special acts continued alongside general laws for many decades, and was not truly phased out until the 1870's.

The first general law for manufactures was established in New York in 1811.[8]

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6 For a history of the early American practice of incorporation, see Joseph Stancliff Davis, *Essays in the Earlier History of American Corporations* [Numbers I-III and Number IV], (Cambridge: Harvard University Press, 1917).

7 This would lead to one of the more celebrated cases regarding the attributes of corporations, *Charles River Bridge v. Warren Bridge* (11 Peters, 420; 193 [1837]). There the Supreme Court significantly modified the *Dartmouth College* case by ruling that the grant of rights in a charter did not prevent the state from creating a similar charter for a rival firm, unless specified in the original charter. See Stanley I. Kutler, *Privilege and Creative Destruction: The Charles River Bridge Case*, (Philadelphia: Lippincott, 1971).

8 Ronald E. Seavoy, *Origins of the American Business Corporation, 1784-1855: Broadening the Concept of Public Service During Industrialization.* (Westport, CT: Greenwood Press. 1982), 9-29.

Originally in force for five years, it was extended until superseded in 1848. It limited capitalization to $100,000, placed control in boards of directors, and limited the term of existence to 20 years. It specified the types of manufactures covered under the law; other industries were not included. The allowable industries were textiles, glass, steel, anchors, bar iron, hoop iron, and sheet lead. The firms typically had only a few shareholders, and shares had a high value. Incorporators filed a certificate with a local official and a copy with the Secretary of State.[9]

This act was ahead of its time. The move towards general incorporation laws did not become a regular feature of state laws until after 1840. At that time it became a constitutional issue as well. Eleven states passed constitutional provisions that prohibited states from passing special acts when the requisite objects could be achieved by general law, beginning with New York in 1846. Table 3.1 lists the states that did so, and the year of enactment.

The movement towards general laws is said to be rooted in the Jacksonian aversion to special privileges, whereby states sought to eliminate favoritism.[10] However this movement did not occur until the middle to late 1840's, well after Jackson has left office. Further doubt is cast on this thesis by the pattern of states that adopted constitutional provisions in prohibiting special acts of the legislature. Of the states that codified prohibitions against special laws, many were not Jackson

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9 Ibid., 65.

10 See William G. Roy, *Socializing Capital: The Rise of the Large Industrial Corporation in America.* (Princeton, NJ: Princeton University Press, 1997); 72-74. J. Willard Hurst, *The Legitimacy of the Business Corporation*.(Charlottesville: University of Virginia Press, 1970), 30-34.

bailiwicks. The 1848 mean Democratic share of the two-party vote for President for the five states in that election that eventually adopted a constitutional provision was 48.2%. For the 24 states that did not adopt a constitutional provision the Democratic share was 49.9%.[11]

Despite this, many states nevertheless passed special acts as a matter of course, even when general laws were available. This could benefit a corporation that received a right or privilege not easily available to competitors. In New York, for example, the state constitution gave the legislature the discretion to determine whether a general law could or could not accommodate a particular need. The state continued to write special charters in significant numbers until 1875. A host of Governors vetoed some of these special acts, and repeatedly issued messages complaining about the impropriety of writing special acts when general laws were available.[12] One other reason given for the movement to general charters was the heavy workload at imposed on legislatures that passed large numbers of special acts in each session.

Not all state constitutions prohibited special acts, but by 1865 most states did have laws on the books providing general laws for some or many industries (also often provided for in their constitutions). Only Kentucky, Louisiana, and Virginia did not have some provision for general laws by then; by 1877, only Louisiana had no such

[11] Presidential data tabulated from Walter Dean Burnham, *Presidential Ballots, 1836-1892*, (Baltimore: Johns Hopkins Press, 1955). Similar results obtain using 1832 presidential data.

[12] Seavoy, *Origins of the American Business Corporation*, 193. For Governor's messages and vetoes see Charles Z. Lincoln, ed., *Messages from the Governors*, (Albany: J.B. Lyon Company, 1909), vol. IV, 513-516, 521-524 (Hamilton Fish), 636-7 (Washington Hunt); vol. V., 129-131, 133-136, 191, 231 (Edwin D. Morgan); 711, 848-9 (Reuben E. Fenton); vol. VI, 167-9, 246, 353 (John T. Hoffman); 639 (John A. Dix); vol. VII, 546-7, 565-6, (Alonzo B. Cornell); vol. VII, 296-7 (David B. Hill); vol. X, 110 (Theodore Roosevelt).

Table 3.1 Constitutional Requirement for General Laws

North	New York	1846
	Wisconsin	1848
	Maryland	1867
	Illinois	1870
	Delaware	1897
	Connecticut	
	Indiana	
	Maine	
	Massachusetts	
	Michigan	
	New Hampshire	
	New Jersey	
	Ohio	
	Pennsylvania	
	Rhode Island	
	Vermont	
South	Missouri	1865
	Mississippi	1890
	Louisiana	1879*
	West Virginia	18xx
	Alabama	
	Arkansas	
	Florida	
	Georgia	
	Kentucky	
	North Carolina	
	Tennessee	
	Virginia	
West	California	1849
	Oregon	1857
	Kansas	1860
	Texas	1878
	Iowa	
	Minnesota	
	Nebraska	

*genealogy uncertain

States codes above had a provision permitting the formation of corporations for any lawful purpose, even if they also had long lists of acceptable objects at the same time. Firms would be included in this category even if they excluded several types of firms from the general law. Typically such exclusions were for industries in some way closely affected with the public interest, such as banking, insurance, railroads, water, and etc.

provision. However, the content of the general laws reveals a gradual broadening of purposes, even as the states nevertheless sought to retain control over corporate objects. New York, California, Indiana, Delaware, Louisiana, Texas and Pennsylvania repeatedly passed laws granting general laws to narrowly defined, specific industries. Over time, they broadened the law to encompass a greater variety of industries. The specificity of corporate objects is evident in the following excerpt from a law in New York that originally provided for corporations for "manufacturing, mining, mechanical or chemical" purposes. By 1890, shortly before repeal, the act read:

> "At any time hereafter, any three or more persons who may desire to form a company for the purpose of carrying on any manufacturing, mining, mechanical or chemical business, or the business of printing, publishing, or selling books, pamphlets or newspapers, or advertising the same or other articles, or for the purpose of purchasing, taking, holding and possessing real estate and buildings, and selling leasing and improving the same, or the business of making butter, cheese, concentrated or condensed milk, or any other products of the dairy, or the business of erecting buildings for church sheds or laundry purposes, and the carrying on of laundry business or the business of slaughtering animals, or for the purpose of towing or propelling canal boats, vessels, rafts, or floats on the canals and navigable rivers of the state of New York, by animal or steam-power, or for the purpose of buying storing, selling, or shipping coal, merchandise and farm produce, their operations not to be confined to the country* in which their certificates shall be filed, or the supplying of hot water or hot air or steam for motive power, heating, cooking or other useful applications in the streets and public and private buildings of any city, village or town in this state, or the business of buying, breeding, grazing, pasturing, dealing in and selling cattle, sheep, hogs, horses and other livestock in the United States of America, British North America and elsewhere, may make, sign and acknowledge, before some officer competent to take the acknowledgment of deeds...." [13]

The original act dated from 1848, the extensions were periodically added until 1890, when New York made a major revision of its laws. The addition of new objects to the laws amounted to a set of industrial acts. Pennsylvania pursued a similar strategy, providing a list 25 different categories of acceptable objectives by 1900.[14] The

13 [*So in the original.] 1890 N.Y. Laws c. 508.
14 1897 Pa. Laws p. 283 § 1 (15 July); Pa. Rev. Stat. p. 772 (Purdons, 1905)

specificity of these acts provides evidence of a type of mentality regarding state control over corporate activities; this mentality gradually gave way to include more activities, and eventually pave the way for laws that allowed corporations to engage in any legal purpose.

In 1875 New York passed a general law that allowed manufacturing firms to incorporate for any legal purpose, not merely from the list in the (later extended) 1848 statute. Both sets of laws operated along side each other until 1890.[15] The catch was that firms chartered under the 1848 law could pursue only those objects that were listed, and these had to be specified in the charter, while the 1875 law allowed them to pursue any legal object, but limited the amount of capital. Allowing a corporation to pursue any lawful purpose, however, was not new. Connecticut did so in1837, as did other states later, such as California in 1870.[16] Allowing a general law for any legal purpose did not in and of itself constitute a liberal policy. Connecticut had other restrictions in place. It did, however, get the legislature out of the business of restricting general incorporation laws to specified areas. Thus these legislatures kept out of the business of mediating industrial acts. By 1888, on the cusp of the New Jersey laws, 18 states allowed a firm to incorporate for any legal purpose. Intriguingly, this provision was spread geographically across the country. It does not exhibit a sectional pattern. It did, however, get the legislature out of the business of mediating charter law for industries based on favoritism. This provision was a key component of the later New Jersey liberalizations.

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[15] 1875 N. Y. Laws c. 611.

[16] Conn Gen. Stat. §393 (1866). Cal. Civ. Code § 286 (1886).

J. Willard Hurst argues that legislators in the middle of the nineteenth century conflated concern over companies with special action privileges with the general business corporation. This led to them resisting granting liberal corporate rights. He acknowledges the need for restrictions for the former on the basis of concerns over balance of power within the polity. But he believes legislators and other actors of the time were mistaken in placing the same concern for corporations chartered for general purposes. Hurst does not believe that corporations chartered for general purposes posed a threat to the balance of power in the polity.[17]

This is a conclusion with which I disagree. Corporations chartered under general law could gain a balance of power advantage by extracting concessions from lawmakers. With general laws there may be more open competition for influence vis-a-vis lawmakers than under political economy of specially chartered corporations. So-called "first movers" that pioneered the implementation of strategy or technology often captured the bulk of their market. They could then leverage this position to pursue advantageous laws. Any economic actor that gains a predominant position in the economy has the potential for political influence. This is manifest in numerous studies, none less so than in Martin Sklar's analysis of antitrust law.[18]

Expansion of Objects. In 1865 then, most states had general laws, but general laws restricted the activities of any one firm to objectives that were specified clearly in the charter. Many states restricted firms to only one such object. State restraint of

[17] J Willard Hurst, T*he Legitimacy of the Business Corporation,* (Charlottesville, University of Virginia Press, 1970), 44-8.

[18] Martin J. Sklar, *The Corporate Reconstruction of American Capitalism, 1890-1916* (New York: Cambridge University Press, 1988).

legitimate objects works in conjunction with the legal concept of *ultra vires*. The doctrine of *ultra vires* asserted that actions beyond the charter were illegal, and hence, actionable.[19] Thus states could, for example, annul the charter and remove all corporate rights of a corporation that pursued objects not specified or granted in the charter.[20]

There is a theoretical import to the restriction of objects. The Chandlerian imperative requires managerial coordination of complex activities in areas where such coordination is more efficient than market transactions. This process may take the form of vertical integration or horizontal consolidation. It may also take the form of expansion to related products that can be produced efficiently with proprietary technologies and coordinating systems set. The expansion to related objects allows firms to harness their competitive advantages in new market areas. When corporations could not expand to related products, their ability to employ their technologies in order to take full advantage of economies of scale and scope was limited.

The range of state policies provides evidence of a different attitude toward corporate activity at the end of the period than existed at the beginning. In 1865 most states restricted corporate activities to narrow areas specified in the general law. The list of permitted objects expanded in a number of states over the course of the next thirty-five years. By 1900 they were barely an impediment to corporate expansion.

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19 For a discussion of *Ultra Vires* see Morton J. Horwitz, *The Transformation of American Law, 1870-1960: The Crisis of Legal Orthodoxy*, (New York: Oxford University Press, 1992), 77-8 (Hereafter identified as. *Transformation of American Law* II); and Clyde L. Colson, "The Doctrine of Ultra Vires In the United States Supreme Court Decisions", 17 *West Virginia Law Quarterly* n. 3 (1836) 179-217, esp. 184-89.

20 Such an action was known in the law as *quo warranto*.

Table 3.2 Expansion of Corporate Objects

		1865	1876	1888	1900
North	Connecticut	none	none	charter	charter
	Delaware				any
	Illinois		any*	any*	any*
	Indiana		charter	charter	charter
	Maine				
	Maryland	any	any	any	any
	Massachusetts	none	none	charter*	charter*
	Michigan		charter	charter	charter
	New Hampshire				
	New Jersey		vertical	vertical	charter/any
	New York			industrial	industrial
	Ohio	charter/indust.	charter/indust	charter/indus	charter/indus
	Pennsylvania	charter	charter	charter	none
	Rhode Island				
	Vermont	none	none	none	none
	Wisconsin			charter	charter
South	Alabama			charter	charter
	Arkansas		charter	charter	charter
	Florida	none	none	none	none
	Georgia				
	Kentucky				charter
	Louisiana	charter	charter	charter	charter
	Mississippi	none	none	none	none
	Missouri		charter	charter	charter
	North Carolina				
	Tennessee	none	none	vertical**	vertical**
	Virginia	none	none	none	none
	West Virginia			charter/indus	charter/indus.
West	California				
	Iowa				
	Kansas				
	Minnesota		charter	charter	charter
	Nebraska				
	Oregon	charter	charter	charter	charter
	Texas		charter	charter	charter

If *blank*, then the law was silent.

If *none*, then no expansion to other areas was permitted. In some states amending of the charter could provide a way around this.
If *vertical*, the could expand vertically to materials acquisition businesses.
If i*ndustrial*, could expand to areas of industry that were substantially the same
If *charter*, could explicitly expand by altering objects in charter.
If any, could expand to any object.
*Allowed expansion to any object authorized in the title.
**Selected industries only.

An encapsulation of state policies allowing firms to expand their corporate objectives is presented in Table 3.2.

It is crucial to recognize how narrowly corporate objects were defined at the middle of the century, and how much more broadly legitimate objects were conceived of by its end. For example, it took an 1852 Massachusetts law to permit firms that manufactured cotton or woolen goods to also produce flax, silk, linen, or india rubber goods.[21] Ohio's laws here are also instructive. Ohio first enacted a general manufacturing law in 1858,[22] and that same year clearly asserted that a corporation may only pursue those objects for which it was authorized.[23] By 1861, manufacturing firm were permitted to extend their business to another article, in same line of business, with majority approval of the shareholders.[24] As late as 1877 it took a new law to allow a company that mined coal or iron to manufacture iron from ores (with 2/3 shareholder approval).[25] An 1886 law permitted firms to enlarge their objects, so long as they remained substantially remain the same (this time with approval by 3/5 of the shareholders).[26]

Many states were silent in regards to the expansion of objects. This included a number of states in the periphery (such as Florida, Kentucky, Louisiana, and Iowa) where incorporation law was not a significant issue. The likely reason is that there were so few industrial corporations seeking amenable corporation laws. A number of

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21 1852 Mass. Acts 195; Mass. Gen. Stat. Ch. 60 § 37.
22 1859 Ohio Laws 145.
23 1858 Ohio Laws 145. Ohio Rev. Code Ch. 29 § 90 (1860).
24 1861 Ohio Laws 58. Ohio Rev. Code c. 25 §169 (1868 supp).
25 1877 Ohio Laws v. 74 p. 21 § 1. Ohio Rev. Code §3867 (1880).
26 1886 Ohio Laws 193; Ohio Rev. Code § 3238a (1892).

states permitted the charter to be modified to expand corporate objects, and in doing so required stockholders to vote on this policy (by majority or super majority). States such as New York and Ohio allowed expansion to industries of the same general nature. In these cases the breadth of the categories would determine the restrictiveness of the policy. If the areas were strictly spelled out, such as in New York, then the policy was relatively more restrictive.

Illinois allowed manufacturing firms to expand to any other permitted area of manufacturing as early as 1849;[27] Maryland had a similar policy by 1860.[28] This was anomalous in 1865, but not so by 1900. Whereas in 1849 Illinois' general laws carefully specified types of permitted activities, by 1872 she allowed firms to incorporate for any lawful purpose. In conjunction with a liberal law on the expansion of objects, this meant that corporations could engage in a wide variety of activities without extensive legal hurdles.[29]

Some states allowed vertical expansion. New Jersey in 1875 allowed firms to purchase mines and manufactures necessary for business (and to issue stock for their purchase).[30] This is an example of "upstream" expansion into materials procurement. Tennessee in 1881 allowed expansion "downstream" so that firms could market and sell the objects they manufactured;[31] and in 1883 she allowed manufacturing firms to erect elevators, hoist, warehouses and transfer tracks associated with their business.[32]

27 Ill. Rev. Stat. c. 25 div. 13 s. 19- 20; c. 25 div. 14 s. 15-16 (1873).
28 Maryland Rev. Stat., art 26 § 60 (1868). This was reaffirmed in 1878; Maryland Rev. Stat. c. 40 § 138. (1878)
29 Ill. Rev. Stat. c. 25 div. 12 s. 1, div. 14 s. 1 (1873); Ill. Rev. Stat. c. 32 s. 1 (1874).
30 N. J. Rev. Stat. p. 187 § 55 (1877).
31 Tenn Rev. Stat. 1710 (1884).
32 Tenn. Rev. Stat. 1864 (1984).

Yet by contrast, even at the late date of 1897, Pennsylvania wrote a new law that limited each firm to only one kind of business, which had to be clearly stated.[33]

Removal of restraints on corporate objectives was one of the most important elements animating "the race to the bottom." But it is important to note that there was significant, and gradual relaxation of policies even before the New Jersey reforms of 1888. Table 3.2 displays less change than actually occurred because states often relaxed limitations on the expansion to new objects, without removing restraints altogether. These relaxations do not show up in the table. It also shows a wide range of variation on this basic constituent element of the very nature of the corporation in the late 19th century.

Another way of getting at this is to examine the spread of adoption of provisions that allow incorporation of any lawful business. We can see the pattern in table 3.3. Connecticut had a general provision dating from 1837. By 1888 19 states had language to this effect. Intriguingly, there is not a distinctive pattern according to section. In part this may have been due to Reconstruction: four southern states passed provisions from 1868-1870.

A state did not need to have a well developed corporation law to enable corporations to exist. Just a few provisions would allow corporations to function. However, a more developed corporation law becomes necessary as economic relations become more complex. A detailed and extensive law may curb or suppress corporate abuses. Southern states had a simple corporation law because they did not have many

[33] 1897 Pa. Laws, p. 283 § 1. (15 July).

Table 3.3 Language Permitting Any Lawful Business

	Connecticut	1837
	New Jersey	1865
	Illinois	1872
	New York	1875 / 1890
	Ohio	By 1880
	Vermont	1882
	Maine	1883
	Rhode Island	1896
	Delaware	1899
	Wisconsin	
	Pennsylvania	
	Indiana	
	Massachusetts	
	Maryland	
	New Hampshire	
	Michigan	
South	Georgia	1843
	Florida	1868
	Kentucky	1869
	Arkansas	1869
	Virginia	1870
	Missouri	1887
	Louisiana	1888
	Mississippi	1892
	Alabama	
	West Virginia	
	North Carolina	
	Tennessee	
West	California	1853 / 1870
	Iowa	By 1860
	Oregon	1862
	Nebraska	1866
	Texas	
	Minnesota	
	Kansas	

corporations. However, they did permit corporations to operate, and they often had liberal provisions (although perhaps as a result of benign neglect).

Term. The original grants of incorporation via special act were typically limited to a set term of existence. The limitation of term as a principle should be familiar to students of American political development. For example, the First Bank and the Second Bank of United States were each chartered for 20 years. The effort to recharter the Second Bank, prompting Andrew Jackson's veto in 1832, is one of the central dramas of antebellum American politics.[34] Limits to terms of existence were considered to be an appropriate lever of control by the state over business corporations.

While explicit limitations on term were likely to be carefully thought out, the lack of a term limitation could result from either a conscious decision or from benign neglect. In the metropole restriction or accommodation was likely to have been carefully thought out, due to the variety of industrial firms and their importance to the state economy. Northeastern states with no specified limits in 1865 included Connecticut, Delaware, Massachusetts, Maine, New Hampshire, Ohio, Rhode Island, Vermont, and Wisconsin. States outside the metropole included Kansas, Kentucky, Louisiana, Oregon (Texas at the time had no general corporation law). By contrast, if manufacturing and corporate activity was a small part of a state's economy, and if, hence, corporate rights were not a major issue and the relevant codes were not long or complicated, omission of term might be a matter of neglect. This would be more likely in the economic periphery. By contrast, eight states relaxed their laws on term

[34] Bray Hammond, *Banks and Politics in America from the Revolution to the Civil War* (Princeton: Princeton University Press, 1957).

Table 3.4 Maximum Term of Existence in Years

		1865	1876	1888	1900
North	Connecticut				
	Delaware			20	perpetual
	Illinois	50	99	99	99
	Indiana	25?	25?	25	25
	Maine				
	Maryland	40	40	40	40
	Massachusetts				
	Michigan	30	30	30***	30***
	New Hampshire				
	New Jersey	50	50	50	perpetual
	New York	50	50	50	additional 50
	Ohio				
	Pennsylvania	20	perpetual	perpetual	perpetual
	Rhode Island				
	Vermont				
	Wisconsin				
South	Alabama	20	perpetual	perpetual	perpetual
	Arkansas	20			
	Florida	20	20	20	20
	Georgia	20	30	30	30
	Kentucky			25 renewable	25 renewable
	Louisiana			perpetual	perpetual
	Mississippi	by charter	by charter	by charter	50
	Missouri	20	20*	50	50
	North Carolina	30	perpetual	30	30
	Tennessee	20	20	20	20
	Virginia	30	30	30	30
	West Virginia	by charter	by charter	50	extend addtl 50
West	California	50	50	50	50
	Iowa	20	20	20	20
	Kansas		20*	20*	20*
	Minnesota	30	30	30**	30**
	Nebraska				
	Oregon				
	Texas		50	50	50

* Kansas allowed successive 20 year extensions of term of existence.
**Minnesota allowed renewal equal to original term.
Tennessee had provisions for renewal.
***Michigan allows extension of additional 30 years.

over the period of this study: Arkansas, Delaware, Illinois, Minnesota, Mississippi, New Jersey, New York, West Virginia. Table 3.4 shows data on limitation of term.

There are two ways of looking at these data: first as a principle of state capacity (and legitimacy) to control corporations, and second as a practical constraint on corporate growth. From the first perspective, many states did have significant restrictions on term in 1865: ten states permitted maximum terms of 30 years of less. This was relaxed only somewhat states by 1900: at that time eight states still had restrictions of 30 years or less. Some of these allowed modification of the charter to extend operations up to the maximum allowable term of existence. How many corporations these laws applied to is unclear. From a logical point of view, if a corporation can be chartered for a thirty year period, most applications will not limit the charter to only ten. However, the language of the statutes was often unclear as to whether the charters were renewable up to the maximum term allowed, or whether they could be renewed for that period.

The second way to look at these data is as a practical constraint on corporate activity. Most states either did not have a limit, or had limits of 50 years or greater. The laggards in this sample are Virginia and Indiana. In addition, states without general laws, such as Mississippi until 1890, granted existence only in legislatively approved charters. By 1900 many of the states, not merely New Jersey, had extended the term of existence.[35] Further, the 50 year limit would hardly come into play for

[35] My strong suspicion is that by the mid-1880's term was no longer a significant restriction in most states. Either the charter could be renewed, or the corporation could be dissolved on paper and a new, but essentially identical, corporation could take its place.

many corporations created after the Civil War until after 1915. States were not likely to abolish through legislation a corporation that was contributing to the economy. It is one thing to restrict corporate economic activity before it begins or before it expands operations; it is quite another to destroy a corporation to that had been producing.

There was a clear movement from early on to relax this constraint. Delaware, for example, was silent on this issue until 1883, when she limited term to 20 years. As part of her general liberalization, copying New Jersey in 1899, she provided for perpetual existence.[36] Note however, that the New Jersey laws were not the first to specifically provide for perpetual existence. That honor goes to Pennsylvania, which passed such a provision in 1874.[37] The limitation of term evinces a gradual change, such that it was largely removed as a significant constraint by 1900.

Capital Limitations. A direct way to limit the possibility of monopoly is to limit the value of capital stock. Many states imposed such restrictions. At the time, capital stock was defined as the total of its stockholder shares, with clearly defined par values. Thus a maximum capital stock requirement limited the amount of initial investment in a corporation. However, if a corporation retained earnings without making distributions to shareholders, then it could increase its cash on hand and/or assets far above a maximum level of capitalization. This would particularly be the case with firms that had at least some degree of monopoly power, and thus extraordinary profits. Thus corporate size as measured by value of products could conceivably be far in

[36] 1883 Del. Laws c. 147 (vol 17); Del. Rev. Stat. § 1916 cl. 1 (1915).
[37] 1874 Pa. Laws p. 76 § 4 (20 April); Pa. Rev. Stat. p. 781 § VIII (Purdons, 1905).

excess of a set limit on capital stock. Nevertheless, many states did impose a limit on capital stock, and also on the amount of debt that a corporation could accumulate.

Fourteen states had a maximum level of capitalization written in law. These are listed in Table 3.5. The earliest was Massachusetts in 1851, with a limit of $500,000; Vermont and Michigan adopted that limit in 1853, as did Pennsylvania in 1854, Arkansas by 1856,[38] and Illinois in 1857. Two other states imposed similar ceilings in the 1850's: Wisconsin by 1858 imposed a limit of $400,000, and Tennessee that year imposed a limit of $200,000, as did Maine in 1862. Thus in the decade before this study begins, nine states imposed maximum capital limitations of no more than $500,000 on manufacturing firms. In addition, Missouri imposed a limit of $2 million in 1864. This new, much higher limit, turned out to be a harbinger of the gradual removal of capital stock limitations.

[Table 3.5 about here]

Limitations on capital stock were concentrated in the northeast metropole. Of the fifteen states with some limit at some time during this study, only six were located outside the Northeast quadrant of the country (Arkansas, Minnesota, Oregon, Tennessee, Virginia, and Wisconsin). Capital stock limitations were concentrated in areas where the corporation thrived, and where the possibility of an extremely large firm existed.

The limits were periodically raised, and then eventually removed. Massachusetts and Pennsylvania each significantly raised their limits in the 1870's,

[38] The exact date of the Arkansas enactment is not clear from the record available to me.

Table 3.5 States with Maximum Levels of Capitalization
(Southern States in Italics)

Massachusetts	1851 $500,000. 1870-1 $1,000,000 for mining, mechanical, manufacturing. Half that for ice, agricultural, horticultural, etc. 1874 $1,000,000 for any lawful purpose.
Vermont	1853 $500,000 1892 $1,000,000
Michigan	1853 $500,000 1865 $1,000,000 1875 $2,500,000 for mining or manufacturing of iron, steel, silver, lumber, or copper 1881 $5,000,000 for specified manufacturing firms 1885 $5000,000 for all manufacturing firms
Pennsylvania	1854 $500,000 1874 $5,000.000. 1891 $10,000,000. 1893 $30,000,000. 1901 Limit removed.
Arkansas	*by 1856. $500,000. Appears to be removed in 1869 revision.*
Illinois	1857 $500,000 for some manufacturing firms. Illinois had two different sections by which a manufacturing company could take a charter. Division 14 had the above limit, Division 13 did not.
Tennessee	*1858 $ 200,000 (I saw no evidence this was removed).*
Wisconsin	by 1858 $4,000,000 (genealogy not clear) by 1878 $250,000 (genealogy not clear).
Maine	1862 $200,000 1883 $2,000,000 1891 $ 10,000,000 1901 Limit removed
Missouri	*1864. $2,000,000* *by 1879 $10,000,000 (genealogy not clear holds until at least 1899).*
Oregon	1864 $2 million.
Minnesota	by 1866 $500,000 (genealogy prior to 1866 is not clear). 1876 $2,500,000 for mining and smelting. 1881 Limits on mining and smelting removed 1883 Limit on all removed.
Virginia	1870-1 $100,000. The law was written with the form of $5000 minimum capitalization, with 20 times that amount for the maximum. Later versions of this same act in the 1883-4 revised statutes had a minimum figure at $500, which would mean a maximum capitalization of $10,000. I found no record of amendment for that change. The revision of 1887 is also $10,000. I have as yet been unable to resolve this discrepancy. The maximum caps are removed in the 1904 rewriting of the law.
New York	1875 $2 ,000,000 1883 $5,000,000 1890 Limit removed New York had two sections of code authorizing charters. One limited objects but not capital. This limit refers to a 1875 law that was permissive in terms of objects.
Indiana	1889: $2,000,000 for gas, oil and drilling firms.

Massachusetts to $1 million, and Pennsylvania to $5 million. Minnesota kept its limit for most firms, but raised the limit for mining and smelting firms to $2.5 million. New York's 1848 manufacturing law was narrowly written, applied only to certain industries, and had no capital stock limitations. New York added a separate general law in 1875 that operated alongside the 1848. Both laws were in force until 1890. The 1875 law allowed incorporation for any industry, but limited capitalization to $2 million. This was raised to $5 million in 1883, and then removed in 1890 when both old laws were repealed and a new law enacted.

At the time of the New Jersey laws, several Northeast states still had capital stock limitations but it was clear that the trend was towards either their removal, or liberalization. Minnesota had removed all such limits by 1883. New York removed its limits in 1890, while Maine increased its limit to $10 million in 1891, and Pennsylvania to $10 million in 1891 and $30 million in 1893, before removing all limits in 1901. Most limits were gone by the end of the century. The conception of the corporation as a natural entity was not possible until some of these these onerous limitations were removed.

Real Estate. A third restriction was on the right to own property. States often limited the amount of real estate a corporation could hold, quantified either by acreage or by dollar value. These limitations are restrictions on property rights in the most literal sense. They serve to constrain corporate size and power. Data on the limitation of real estate is reported in Table 3.6.

Eighteen states had a "soft" limit in place by 1865. I define a soft limit as one

Table 3.6 Limitations on Real Estate

		1865	1876	1888	1900
North	Connecticut	Soft	Soft	Soft	Soft
	Delaware	Soft	Soft	Soft	None
	Illinois	Soft	Soft	Soft	Soft
	Indiana		None	None	None
	Maine	Hard**	Hard**	Hard**	Hard**
	Maryland	None	None	None	None
	Massachusetts	Soft	Soft	Soft	
	Michigan	Hard***	Hard***	Soft	Soft
	New Hampshire				
	New Jersey	Soft	None	None	None
	New York		Soft	Soft	Soft/Hard
	Ohio	Soft	Soft	Soft	Soft
	Pennsylvania	Hard	Hard	Hard	Hard
	Rhode Island				
	Vermont	Soft	Soft	Soft	Soft
	Wisconsin	Soft	Soft	Soft	Soft
South	Alabama	Soft	Soft	Soft	Soft
	Arkansas	Soft	Soft	Soft	Soft
	Florida		Soft	Soft	Soft
	Georgia	Soft	Soft/hard*	Soft/Hard*	Soft/Hard*
	Kentucky				Soft
	Louisiana			Soft	Soft
	Mississippi	Hard	Hard	Hard	Hard
	Missouri		Soft	Soft	Soft
	North Carolina	Soft	Hard	Hard	Hard
	Tennessee	Soft	Soft	Soft	Soft
	Virginia	Soft	Soft	Soft	Soft
	West Virginia	Soft	Soft	Soft	Soft
West	California		Soft	Soft	Soft
	Iowa				
	Kansas				
	Minnesota	Soft	Soft	Soft	Soft
	Nebraska				
	Oregon	Soft	Soft	Soft	Soft
	Texas		Soft	Soft	Soft

Blank means no provision or mention of limit
Hard means a definite dollar or acreage limit on real estate holdings
Soft means a "necessary and proper for legitimate objects" standard
None means that there is language permitting unlimited holdings.
Note in particular that within the category of *hard* limits, there can be considerable variation.
*Georgia limited holding of Foreign corporations to 5000 acres as of 1874.
**Maine limited real estate holdings to capital stock.
***3000 acre Limit, 10,000 acre limit for mining firms.
Wisconsin allowed real estate up to an amount determined in law, but did not thereby impose hard limits

where the state code limits real estate holdings to that which is "necessary and proper" to conduct the legitimate objects of the corporation. This means that, as in many other issue areas, the real bite of the limitation would depend on the strength of enforcement. The limitations at that time were spread throughout the Northeast and South, and somewhat less prevalent in the West.

A hard limit is one where there is a dollar or acreage limitation on corporate holdings. Three states had these by 1865. Pennsylvania limited real estate holdings for mining companies to 2000 acres, and also had a soft limit for other firms.[39] Mississippi had the most onerous restrictions, even as they raised their limits over time. By 1857 there was a $50,000 limit for corporations in general, but $500,000 for manufacturing companies.[40] Maine limited real estate holdings to the amount of capital stock, which itself was limited in 1862 to $200,000.[41]

There were exceptions that allowed companies to accept property for obligations of debt. For example, Connecticut early on allowed corporations to take real estate to satisfy debt, as did Virginia, but Virginia also required that corporation extinguish the same within a time certain.[42] New York similarly allowed corporations to hold mortgages to secure debts as of 1871, which applied to the 1848 manufacturing law; the parallel general law of 1875 required them to extinguish property acquired for

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39 1849 Pa. Laws, p. 563-8 §§ 3, 21 (7 April).

40 Miss Rev. Stat c. 35 s. 2 art. 5 (1857).

41 Maine Rev. Stat. 48. s. 9 (1857); Maine Rev. Stat. c. 48 s. 18 (1871). The limits on capital stock, and hence real estate were raised to $2 million in 1883, $10 million in 1891, and removed in 1901. Maine Rev. Stat. c. 48 s. 17 (1883); Maine Rev. Stat Supp. c. 48 s. 17 (1895). Maine Rev. Stat. c. 47 s. 7 (1904).

42 Conn. Gen. Stat. .§ 406 (1866). 1880 Conn. Acts 97. Va. Code Ann. Ch. 56 § 3 (Ritchie 1860).

a debts within three to five years.[43] Some states were more strict than others in requiring firms to sell real estate acquired for debt owed. Illinois set procedures for annual public auctions of excess real estate, and required that excess real estate held over five years be forfeit.[44]

In the late nineteenth century, currency was often hard to come by, and thus the acceptance of property for legitimate obligations in hinterland areas made sense. It was a form of securitizing real estate. Yet, this also went on the New York, in the heart of the Northeast metropole.

There were few changes over the course of this study on limitations on real estate. By 1888, on the cusp of the New Jersey liberalizations, 21 states in the sample had soft limits, four states (Georgia, Pennsylvania, Maine, and Mississippi) had hard limits, and three states had laws specifically stating there was no limit on corporate real estate holdings. Real property limitations in Mississippi were raised to $1 million in 1890, and to $2 million in 1892.[45] Most notable are the relaxations of the two states most identified with the "race to the bottom," New Jersey and Delaware. However, neither of these states were the first to grant explicit permission to purchase, hold, or convey any amount of real estate. That honor belongs with Maryland (1860).[46]

Internal Governance

The second area of statutory incorporation law in this study is composed of

43 1871 NY Laws c. 481. 1875 NY Laws c. 611 § 2. Five years required an extension from the court.
44 Ill. Rev. Stat. c. 32 s. 5 (1874).
45 Miss. Rev. Stat. c. 25 s. 838 (1892).
46 Md. Rev. Stat. art. 26 s. 42 (1860).

provisions related to internal corporate governance. These provisions affect control of the corporation. Recall that Berle and Means identify both legal and extra-legal means of managerial corporate control; obviously, only legal elements enter the statute books. Statutory elements of internal governance that contribute to management control include the power to value assets purchases with corporate stock, to value intangible assets, to issue multiple classes of stock, to buy back shares, to set the timing of dividends, to make major transactions without shareholder approval, and the weakening of preemptive shareholder rights.

Director Control. In a proprietary corporation, the majority stakeholder and management are essentially combined in one person, family or partnership. The original incorporators were likely to be the management of the newly formed corporation. It is only with the transition to corporate capitalism that we see a full separation of management and ownership. However, this was built upon prior practice. Many laws placing control in the management were written in the years following the Civil War, and thus predate corporate capitalism.

The very first general laws authorized day to day management by a board of directors. This was the practice in nearly every general corporation statute that followed. One of the few exceptions was Tennessee, which from 1849 allowed that affairs *may* be managed by directors, before changing the law in 1875 so that the corporation *had* to be managed by directors.[47] But this is an exception to the rule. Attempts to run corporations entirely by shareholders did not find fertile ground.[48]

[47] Tenn. Rev. Code 1452 (1858); 1875 Tenn. Rev. Code 1706 (1884).

[48] William Roy at one point notes that there did not have to be a directors of a corporation at all.

Virtually every state granted corporations the right to make by-laws. These by-laws related to manner of voting (for example permitting proxy voting), chain of command, setting up internal controls, and the like. By-laws typically could only be changed by a vote of shareholders. This ranged from majority to supermajority votes.

One of the earliest powers given to directors was to set the timing for calling in subscriptions. Stock of newly formed corporations was sold by subscription, with actual payments made in installments. Most states had explicit requirements regarding how much stock had to be subscribed, and how much actually had to be paid in before commencing business. This served as a constraint on the maximum amount of stock incorporators would request; if, say, 50% of the capital had to be paid in before commencing business, asking for authority to raise an unduly high amount of capital would hinder corporate formation.

Directors were given authority over the timing to call in subscriptions. This power was nearly uniform across the states. Shareholders typically could not vote shares until they were called in, but shares had to be called in proportion to amount subscribed. Shareholders at early stages of incorporation would have the same proportion of stock, whether a small or a large percentage was actually paid in. Thus voting power would not change merely because more stock was called in, unless a (minority) stockholder had subscribed for more that he was able to pay. Director authority to call in subscription could be used as a weapon against such subscribers. In addition, states had elaborate procedures for declaring the unpaid subscriptions that

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Socializing Capital, 154.

became due. In some states these procedures constituted a significant proportion of the corporation law as a whole. Through these procedures, default subscriptions could become property of the corporation, and then dispensed or auctioned off to other individuals. This power gave directors some leverage over shareholders from the outset.

Nevertheless, constraints on management and obligations to shareholders were written into the charter documents. The most significant of these required shareholder approval for major transactions. For example, shareholder approval, whether by majority or supermajority, was required in some states in order to increase or decrease capital, to issue preferred stock, to enter into a new line of operations, to merge with or purchase the stock of another company, to extend the term of existence, to purchase real estate, or to modify by-laws or the charter document itself. These laws constrained management's ability to make major transactions without shareholder approval.

Of the 35 states in the dataset, 21 were silent in 1865 as to control of decisions affecting the capital stock; many simply had not contemplated alterations of corporate financial structure. Of the remaining states, 7 required a supermajority to approve such alterations, and 6 merely required a majority. Alabama did not distinguish between management and shareholders at all, simply granting the corporation the power to alter the capital stock. By 1900 only 7 states were silent on these provisions, 13 required a majority, and 12 a supermajority. New Jersey granted directors the power to make such changes in 1893, but it was not the first. Tennessee in 1875 gave directors the right to make applications for altering the capital stock of the corporation.[49] The broad contours regarding changes in capital structure are shown in Table 3.7.

Southern states were less likely to have provisions on the books for the alteration of capital stock. In 1865, 3 of 12 (25%) Southern states had such provisions, compared with 6 of 16 (38%) Northern states. By 1900, 7 of 12 (58%) Southern states had such provisions, compared with 13 of 14 (93%) in the North, and 6 of 7 (86%) in the West. The provision of such provisions in the law in the South was less developed within each state in the South, and thus in the South as a whole, but it was not non-existent.

The breadth of policies for any one state ranged from relatively simple to rather complicated. For example, New Hampshire designated directors to manage the company, required unanimous shareholder consent to increase or reduce the number of shares, and allowed directors to make assessments on subscribed stock. These provisions, written in 1867, were virtually unchanged by 1900.[50] By contrast Michigan at different times allowed directors to call in subscribed stock as they saw fit(1853);[51] alter the number of shares the stock was divided into, so long as this did not increase overall capital stock (1857);[52] required 2/3 shareholder approval to increase capital stock (1865);[53] required 3/5 shareholder approval for major transactions involving title

[49] Tenn. Rev. Code 1695 (1884).
[50] N.H. Rev. Stat. c. 146 §§. 4-15 (1876).
[51] Mich. Gen. Stat. 4138 (1882).
[52] Mich. Comp. Laws, 2866-8 (1872); 1857 Mich. Pub. Acts 186.
[53] Mich. Comp. Laws, 2870 (1872). 1865 1872 RS 2870; 1885 Mich. Pub. Acts 232 s. 2, (p. 343); Mich. Gen. Stat. Supp. 4141A1 (1890).

Table 3.7 Power to Alter Capital Stock

		1865	1876	1888	1900
North	Connecticut		supermajority	supermajority	supermajority
	Delaware			supermajority	supermajority
	Illinois	supermajority	supermajority	supermajority	supermajority
	Indiana			supermajority	supermajority
	Maine	supermajority	supermajority	supermajority	majority
	Maryland		majority	majority	majority
	Massachusetts		majority	majority	majority
	Michigan	supermajority	supermajority	supermajority	supermajority
	New Hampshire				
	New Jersey		supermajority	supermajority	Directors
	New York		supermajority	supermajority	supermajority
	Ohio	supermajority	supermajority	supermajority	supermajority
	Pennsylvania		majority	majority	majority
	Rhode Island				supermajority
	Vermont	majority	majority	majority	majority
	Wisconsin	majority	Supermajority	supermajority	supermajority
South	Alabama	corporation	majority	majority	majority
	Arkansas		majority	majority	majority
	Florida		majority	supermajority	supermajority
	Georgia				
	Kentucky				supermajority
	Louisiana			majority	majority
	Mississippi				
	Missouri	majority	supermajority	majority	majority
	North Carolina		majority	majority	majority
	Tennessee	supermajority	directors	directors	directors
	Virginia				
	West Virginia				
West	California	supermajority	supermajority	supermajority	supermajority
	Iowa				
	Kansas	supermajority	supermajority	supermajority	supermajority
	Minnesota	majority	majority	majority	majority
	Nebraska	majority	majority	majority	majority
	Oregon	majority	majority	majority	majority
	Texas		majority	majority	majority

Blank means the law was silent

Majority means shareholders representing a majority of the stock have the power to alter the capital stock.

Supermajority means shareholders representing a supermajority of the stock have the power to alter the capital stock.

Directors means the directors had authority to alter capital stock.

Corporation means the corporation could alter capital, but the decision rule was not specified.

transfers (1869);[54] allowed the firm to move to another location in the state with 2/3 shareholder approval (1875);[55] required 2/3 shareholder approval to expand corporate objects (1875);[56] with a majority of shareholder approval allowed the firm to establish offices and hold meetings outside the state(1885);[57] and more. This variability is necessarily vastly simplified as presented in Table 3.7.

Preferred Stock. Allowing firms to issue multiple classes of stock concentrates greater power in management.[58] The logic is that these give management the opportunity to shift the timing and distribution of monies to the advantage of one class as opposed to another. Multiple classes of stock has an early history, evident in Table 3.8. The overall pattern here is similar to the other provisions: earlier appearance and greater prevalence in the North than in the West or South, but not to the exclusion of the latter two sections. By 1876 four Northern states, three Southern states, and two Western states offered multiple classes of stock in some form or another.

There is a second "wave" of liberalization in this area in the early 1890's, as five more states offer preferred stock, likely an artifact of the "race to the bottom." There sometimes were other restrictions on preferred stock. For example, Michigan

[54] Mich. Comp. Laws, 3434 (1872).
[55] Mich. Gen. Stat. 4145 (1882).
[56] MI 1881 Acts 187 p. 214 s. 18. Amended by 1882 Mich. Pub. Acts 232 § 8; Mich. Gen. Stat. Supp. 4161a7.
[57] 1885 Mich. Pub. Acts 232 §§ 18, 20; Mich. Gen. Stat. Supp. 6161b9 (1890).
[58] Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932), 143, 160-61, 174, 191. There are additional powers that may accrue to management, including the power to control accounting (202), and to alter the original contract rights of securities holders (207). However, these advances occur after 1900, the period of study here.

allowed preferred stock up to 2/3 of the actual capital paid in, with dividends limited to 8%. If the dividends on the preferred stock were not paid, holders had the right to vote for directors, yet were not liable for debts in case of insolvency (except for wages due labor).[59]

New Jersey, although the first to codify preferred stock in 1860, is far from alone in 1888, much less in 1900. The New Jersey reforms in this area are an inflection point, not a breakthrough. The existence of preferred stock precedes the era of corporate capitalism. While it did provide management with an additional lever of control, it was put in place before ownership and management became separated.

Some states set strict rules regarding the right to buy new issues of stock from an existing corporation. These states typically gave shareholders a “preemptive” right to purchase new issues of company stock in proportion to the stock that they already held.[60] Without these regulations, management had a tool for the distribution of what might well become highly profitable shares. I found only two states with clear specific provisions to protect a shareholder's preemptive right: Massachusetts in 1870, and Alabama by 1886.[61] Only four states had clear statutory provisions regulating the valuation of assets purchased with company stock. Illinois in 1849 allowed stock to be purchased only with money; in 1857 she made an exception for stock purchased with land, which had to be evaluated by independent third party.[62] Tennessee (1858) only

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[59] 1893 Mich. Pub. Acts 197, (p302).
[60] Ibid. 145-6
[61] Ala. Code § 1675 (1887); 1870 Mass. Acts 298; Mass. Gen. Stat. Ch. 224 § 7, 25; 1871 Mass. Acts 392 §1.
[62] Ill. Gen. Stat. c. 25 div. 13 § 14, & div. 14 §. 12 (1873).

Table 3.8 First Year Allowing Preferred Stock

North	New Jersey	1860	
	Maryland	1868	
	Ohio*	By 1870	
	Pennsylvania	1872	
	New York**	1880	
	New Hampshire	1891	
	Connecticut	1893	
	Indiana	1893	
	Michigan	1893	
	Delaware	1899	
	Maine	1901	
	Massachusetts	no	
	Illinois		
	Rhode Island		
	Vermont		
	Wisconsin		
South	West Virginia	1864	
	Missouri***	1868	
	Alabama	1875	
	Georgia	1882	(via case law)
	Kentucky	1893	
	North Carolina	1901	
	Virginia	no	
	Louisiana	no	
	Mississippi	no	
	Arkansas		
	Tennessee		
	Florida		
West	Minnesota	1867	
	California*	By 1870	
	Kansas	1895	
	Iowa		
	Nebraska		
	Oregon		
	Texas		

*California and Ohio refer to preferred stock in their revised statutes but the date of origin in not specified.

**New York in 1880 referred to allowing the exchange of preferred stock for common; I am not sure of the date when preferred was first offered.

*** The 1875 Missouri Constitution required unanimous consent in order to offer preferred stock.

allowed money to be used to pay for capital stock, while Kansas (1859) allowed stock purchases with property so long as a judge-appointed freeholder ascertained the true value of the property.[63] New Jersey (1891) allowed the corporation to remove restrictions on the sale of stock with a vote of 2/3 of the shareholders, thus allowing a supermajority of shareholders to remove the preemptive right for all shareholders.[64] Delaware (1883) required stock purchases be made in cash, but allowed a corporation to make purchases with stock, valued by the directors. In 1899 Delaware adopted a code based on New Jersey's innovations, and at that time made director's valuation of assets purchased with corporate stock conclusive.[65]

Having discretion in the timing of dividends and to buy back shares also gives management the opportunity to affect share value. Most states allowed directors to determine the timing for the payment of dividends. There were a few notable exceptions. Virginia (1836) and Pennsylvania (1849) each provided for dividends to be declared semi-annually.[66] Arkansas required semi-annual dividend payments, but also required that ten percent over the amount of the original capital stock had to be set aside as a reserve before payment of dividends.[67] By contrast, Tennessee (1881) required dividends be paid when over four percent of the capital stock was held in the corporate treasury.[68] But again, most states gave discretion to management over the timing and amount of dividends. The major constraint was legal: in most states

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63 Tenn. Code § 1456 (1858); Tenn. Code § 1856 (1884). Kan. Stat. Ann. c. 33 § 2 (1860).
64 N.J. Rev. Stat. § 220, p. 953 (1896).
65 1883 Del. Laws c. 147 v. 17 §§ 29, 30; 21 Del. Laws, c. 273; 22 Del. Laws c. 392; Del. Rev. Stat. § 1928 (1915).
66 Va. Code Ann. Ch. 56 § 30 (Ritchie 1860); 1849 Pa. Laws p 565 § 14 (7 April).
67 Arkansas Rev. Stat. c. 95 § 10 (1858).
68 Tenn. Code § 1870 (1884).

directors were personally liable if dividends were declared and paid when the corporation was insolvent, or if the payment would render the corporation insolvent.

Several states insisted upon protecting minority stockholder rights by requiring cumulative voting of shares for directors. This meant that, if several board seats were up for a vote, a shareholder could combine votes for all seats, and allocate them as desired. For example, a shareholder with 100 shares at a meeting where 4 directors were chosen could allocate all 400 votes for one director. This gave minority shareholders greater likelihood of capturing at least one seat. States with statutory provisions included Illinois (1872),[69] Michigan (1885),[70] Ohio (by 1893).[71] West Virginia (1872) and Missouri (by 1875) each put a requirement for cumulative voting in their state constitution.[72]

Liability

Shareholder Liability. Limited liability was by no means universal in the19th century. Limiting liability was shaped in part by the manner in which shares were sold, and cannot be properly understood otherwise. Shares of stock were sold via subscription. An individual made a contract to purchase shares, paying for part of the subscription up front, with the rest to be called in later. Typically, subscribers were liable up to the full amount subscribed, not merely what they had actually paid in, but this was by no

69 Ill. Rev. Stat. c. 32 § s (1874).
70 1885 Mich. Acts 112 (p. 116); Mich. Rev. Stat. Supp. 4885a (1890).
71 1895 Ohio Laws v. 93 p. 230; v. 50 p. 274 § 9; Ohio Rev. Code Ann. § 3245 (1900).
72 W. Va. Const. of 1872 art. XI § 4; Missouri Const. art xii § 6 (1875). Mo. Rev. Stat. c. 21 § 712 (1879).

means a universal rule.[73]

Table 3.9 shows extent to which limited liability had spread among the states in the period from 1865-1900. By 1865 most states had at least simple provisions on the books for limited liability, but some were more elaborate. Several states provided for additional shareholders' liability for obligations due to miners, laborers, and workers. These were Illinois (1849), Massachusetts (1851), Michigan (1853), Pennsylvania (1854), Tennessee (by 1858), and Wisconsin (by 1858), and Indiana (1875).[74] No state instituted additional liability for labor after 1875, and no state removed labor liability after that date. These policies are indicative of the strength of labor at a fairly early date, far in advance of the labor strife of the 1890's.

There were other forms of additional liability. In Pennsylvania, if the capital stock was withdrawn and returned to the stockholders leaving the corporation unable to pay its debts, the shareholders remained liable to creditors up to the amount returned to them.[75] Two of the most interesting cases are California and Ohio. California had proportional shareholder liability up to the full amount of debt owed (this was actually mandated in the state Constitution of 1849); she changed the law to make shareholders liable up to the amount subscribed in 1876.[76] Ohio mandated double liability in 1851,

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73 For the purposes of this study I categorize liability limited up to the value of the subscription as limited liability, even though this means that it was possible a creditor could seek monies from shareholders for unpaid subscriptions.

74 1854 Pa. Laws, p. 215 § 2 (27 March); 1874 Pa. Laws, p. 101 § 39 cl. 11 (29 April); 1855 Mass. Acts 298; Mass. Gen. Stat. Ch. 60 § 12 (1860); 1851 Mass. Acts 133 §15; 1851 Mass. Acts 252; 1852 Mass. Acts 9; 1855 Mass. Acts 146 § 1. 1878 Ind. Rev. Stat., Ch. 84; 1875 Ind. Acts p. 29;1873 Ind. Rev. Stat. c. 25 div 13 § 18; Mich. Rev. Stat. 2852 (1872); Tenn. Code § 1464 (1858). 1858 Wis. Rev. Stat. c. 73 § 25.

75 1874 Pa. Laws, p. 101 §39 cl. 4 (29 April).

76 Cal. Const. of 1849, art. IV § 36; 1850 Cal. Stat. 347, § 32; Cal. Gen. Laws § 777 (1870); Cal. Civ. Code § 322 (1886).

Table 3.9 Shareholder Liability

		1865	1876	1888	1900
North	Connecticut				
	Delaware				Limited
	Illinois	Labor	Labor	Labor	Labor
	Indiana		Labor	Labor	Labor
	Maine	Extra*	Extra*	Limited	Limited
	Maryland	Limited	Limited	Limited	Limited
	Massachusetts	Labor	Labor	Labor	Labor
	Michigan	Labor	Labor	Labor	Labor
	New Hampshire	Limited	Limited	Limited	Limited
	New Jersey	Limited	Limited	Limited	Limited
	New York	Limited	Limited	Limited	Limited
	Ohio	Limited/extra	Limited/extra	Limited/extra	Limited/extra
	Pennsylvania	Labor/Extra	Labor	Labor	Labor
	Rhode Island	Extra	Limited	Limited	Limited
	Vermont	Limited/extra**	Limited/extra**	Limited/extra**	Limited/extra**
	Wisconsin	Labor	Labor/extra***	Labor/extra***	Labor/extra***
South	Alabama	Limited	Limited	Limited	Limited
	Arkansas	Limited	Extra (double)	Extra (double)	Extra (double)
	Florida	?(1868)	Limited	Limited	Limited
	Georgia	Limited	Limited	Limited	Limited
	Kentucky			Limited	Limited
	Louisiana	Limited	Limited	Limited	Limited
	Mississippi	Limited/extra	Limited/extra	Limited/extra	Limited/extra
	Missouri		Limited	Limited	Limited
	North Carolina		Charter		
	Tennessee	Labor	Labor	Labor	Labor
	Virginia		Limited	Limited	Limited
	West Virginia	Limited	Limited	Limited	Limited
West	California	Extra	Limited	Limited	Limited
	Iowa	Limited	Limited	Limited	Limited
	Kansas	Extra (double)	Extra (double)	Extra (double)	Extra (double)
	Minnesota	Limited	Limited	Limited	Limited
	Nebraska				Limited
	Oregon	Limited	Limited	Limited	Limited
	Texas		Limited	Limited	Limited

Labor indicates extra liability to pay workers.
Extra indicates some form of proportional, double, or other extra liability.
Charter indicates that charter must specify.
*Maine had limited liability that extended for one year after transfer of shares.
**Vermont had limited liability, but made shareholders individually liable if the capital stock was withdrawn.
***Wisconsin had a provision for extending liability past transfer date for corporations that held secrets that might adversely affect the share price.

relaxing to limited liability in 1854.[77] Gas companies there had double liability; and manufacturing companies that took advantage of a provision permitting them to increase their capital stock at the same time had to accept proportional liability beyond the amount of the original shares.[78] Kansas (1860) and Arkansas (1868) each had a constitutional provision mandating double liability.[79] These examples demonstrate state action in the regulation of the corporation on this issue, and some variety in policies that were adopted. By and large, however, limited liability was largely accepted before the enactment of the New Jersey laws.

Director Liability. Special liability imposed upon directors is rarely remarked upon in the literature. Yet states routinely sought to constrain director actions. Typically such provisions made the directors jointly and severally liable for undesirable financial transactions. States made directors liable if they authorized and paid shareholders dividends when the corporation could not pay its debt, or if those payments rendered the corporation unable to pay its debts. Directors who were either absent at the meeting authorizing an illegal dividend, or that voted on the record against it, were exempt from liability.

Director liability appears to have first been written into the charter of the Bank of New York in 1791 (it was later that same year also written into the charter of the First Bank of the United States).[80] This feature was prevalent in many general laws at

[77] Ohio Const. art 13 § 3 (1851); also Ohio Rev. Code § 3258 (1880); 1854 Ohio Laws 44; Ohio Rev. Code Ch. 29 § 95 (1860).

[78] 1865 Ohio Laws 134. Ohio Rev. Code Supp c. 25 § 445-49 (1868).

[79] Ark. Const. Of 1868 art. V § 48; Kan. Const. Of 1860 art. XII § 2. Kansas also codified this in statute law in 1868,complete with procedures to attach personal property: Kan. Gen. Stat. c. 23 § 1204-6 (1889).

[80] Edwin J. Perkins, American Public Finance and Financial Services, 1700-1815, (Columbus, OH:

their outset. In fact, Massachusetts placed such liability requirements on chartered corporations in 1838, even before it wrote a general law.[81]

There were other uses of director liability. In some states liability was placed on directors when they did not follow procedures set in law, such as filing required papers with the state. This was the case in Vermont (1853).[82] Directors were made liable by Rhode Island for filing willful false misrepresentation (1857),[83] by Tennessee for loans to shareholders or for dividends that were required had but not paid,[84] and by New York for overissue of securities backed by corporate property (1892).[85]

Directors could also be singled out for fraud. Maine in 1844 made the corporation treasurer subject to fine and imprisonment for not filing required financial statements with the state. Tennessee decreed that keeping false books, directing funds to unauthorized activities (1875) could result in a forfeiture of the charter.[86] More of these provisions were written into law as the century progressed; few states took provisions off of their books.

Director liability acted as a substitute for what today would be state regulatory provisions over corporate governance. Table 3.10 displays a very broad brush picture of the distribution of these laws. While I note which states had any law that placed

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Ohio State University Press, 1994), 374-5; Henry Doment, *A History of the Bank of New York, 1784-1884*, (New York: G. Putnam & Sons, 1884) 8; Shaw Livermore, "Unlimited Liability in Early American Land Companies" *Journal of Political Economy* 43 (1935), 683. John Thomas Holdsworth, *First Bank of the United States,* (Washington: Government Printing Office, 1910), 126.

81 Mass. Gen. Stat. Ch. 60 §§ 23-26, 30 (1860).
82 Vt. Gen. Stat. c. 86 § 62-3 (1863).
83 R.I. Rev. Stat. c. 128 § 18 (1857).
84 Tenn. Code § 1870 (1884).
85 1888 N.Y. Laws c. 394.
86 Tenn. Code §§ 1716-18, 1856 (1884).

Table 3.10 Director Liability

		1865	1876	1888	1900
North	Connecticut	Extra	Extra	Extra	Extra
	Delaware			Extra	Extra
	Illinois	Extra	Extra	Extra	Extra
	Indiana				
	Maine	Extra	Extra	Extra	Extra
	Maryland	Extra	Extra	Extra	Extra
	Massachusetts	Extra	Extra	Extra	Extra
	Michigan	Extra	Extra	Extra	Extra
	New Hampshire	?	Extra	Extra	Extra
	New Jersey	Extra	Extra	Extra	Extra
	New York	Extra	Extra	Extra	Extra
	Ohio			Extra	Extra
	Pennsylvania	Extra	Extra	Extra	Extra
	Rhode Island	Extra	Extra	Extra	Extra
	Vermont	Extra	Extra	Extra	Extra
	Wisconsin	Extra	Extra	Extra	Extra
South	Alabama				
	Arkansas				
	Florida		Extra	Extra	Extra
	Georgia				
	Kentucky				Extra
	Louisiana				
	Mississippi	Extra	Extra	Extra	Extra
	Missouri	Extra	Extra	Extra	Extra
	North Carolina		Extra	Extra	
	Tennessee	Extra	Extra	Extra	Extra
	Virginia	Extra	Extra	Extra	Extra
	West Virginia	Extra	Extra	Extra	Extra
West	California	Extra	Extra	Extra	Extra
	Iowa				
	Kansas		Extra	Extra	Extra
	Minnesota		Extra	Extra	Extra
	Nebraska				
	Oregon	Extra	Extra	Extra	Extra
	Texas		Extra	Extra	Extra

Extra means that the state had at least one law on the books placing additional liability on directors. If there is no entry, the law was silent.

extra liability on management, many states added additional provisions over the years. This appears to have been an attempt to regulate fiscal responsibility of the corporation without creating a bureaucracy. Interestingly, it does not appear to have been a major restrain on corporate formation, as corporate-friendly also had these provisions.

Combinations

Mergers. The Chandlerian imperative requires enabling the coordinating capacities of managers. Combinations can be formed by informal agreement, by trusts, by mergers, and by holding companies. Mergers can be formed horizontally, with firms in same or similar industries, or they can be formed vertically with firms in upstream or downstream enterprises. Note that allowing any two firms to combine need not be either vertical or horizontal; it would merely be consolidation of firms in totally separate areas. However, such a combination would do little to harness the Chandlerian imperative of managerial coordination.

Without a general law, a merger required an act of the legislature. In this regard, mergers of railroads preceded that of manufacturing corporations. In general, states were careful to allow mergers of railroads that connected to form continuous lines, while prohibiting mergers of competing lines. This distinction was not always as clear in practice as theory might desire; a parallel road might compete with a given road, but also provide continuity not otherwise available over other segments.

States at first allowed mergers under carefully delineated circumstances. Illinois, a state that tended to be restrictive, provides a good example. Beginning in

1872, corporations there could merge with an other corporation of the same general character, in the same vicinity, provided that no more than two such corporations combined, and that 2/3 of the shareholders in each approved.[87] Michigan allowed mining companies to consolidate in 1857, but in 1871 included the proviso that their lands must be adjoining.[88] Maryland is an interesting case. The constitution of 1867 required a three person commission be formed to draft new corporation laws. This resulted in what for its time was a liberal law that allowed any two firms to merge.[89] By contrast, Ohio (1868) permitted horizontal mergers of mining firms or of manufacturing firms, but not across two or more industrial sectors.[90] A separate Ohio law allowed firms in designated industries ("oil, salt, refining, purifying, mining ores, or manufacturing the same") to combine. The increase in size of the new firm was limited to three times the size of any of the original companies.[91] The overall pattern can be seen in Table 3.11.

Allowing consolidations under particular conditions was not limited to the Northeast, although these were more prevalent there than in the South or West. Missouri (1870), Alabama (1873), and Louisiana (1874), each allowed horizontal mergers among firms of the same general nature, with approval of a supermajority of the stock.[92] Minnesota (1876) allowed mining companies to acquire a firms that

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87 Illinois Rev. Stat. c. 32 §§ 50, 52, 56, 59 (1874).
88 1857 Mich. Pub. Acts p. 437; 1871 Mich. Pub. Acts p. 10; Mich. Comp. Laws 2879-83, 2892-6 (1872).
89 1868 Md. Laws c. 471 § 36; Md. Rev. Code 23 § 36 (1878).
90 1868 Ohio Laws v. 65 p. 50 §1. Ohio Rev. Stat. § 3864 (1879).
91 1868 Ohio Laws 50; Ohio Rev. Stat. Supp. c. 25 § 459-61 (1868).
92 1879 Mo. Rev. Stat. c. 221 §§ 944-46; 1872-3 Ala. Acts 37, p. 82; 1874 La. Acts p. 158; 1875 La. Acts. p. 18.

Table 3.11 The Right to Merge

		1865	1876	1888	1900
North	Connecticut				
	Delaware				any
	Illinois		horizontal***	horizontal***	horizontal***
	Indiana				
	Maine				any??
	Maryland		any	any	any
	Massachusetts				
	Michigan		horiz.****	horiz.****	horiz.****
	New Hampshire				
	New Jersey			Horiz. (limited)	any
	New York		vertical	vert. & horiz.	vert & horiz.
	Ohio		any	any	any
	Pennsylvania				
	Rhode Island				
	Vermont				
	Wisconsin				
South	Alabama		horizontal	horizontal/vertical	horizontal/vertical
	Arkansas				
	Florida				
	Georgia				
	Kentucky				any
	Louisiana		horizontal	horizontal	horizontal
	Mississippi				
	Missouri		horizontal	horizontal	horizontal
	North Carolina				
	Tennessee				
	Virginia				
	West Virginia				
West	California				
	Iowa				
	Kansas			any	any
	Minnesota		vertical (mining)	vertical (mining)	vertical (mining)
	Nebraska				
	Oregon				
	Texas				

If *blank*, then the law was silent.

If *prohibited*, then a corporation could not merge or purchase shares in another company. Some states in this category did have exceptions for the satisfaction of debts.

If *vertical*, then a corporation could purchase companies that manufacture supplies for authorized business, or transportation firms involved in distribution of their product.

If *horizontal*, then a corporation could merge with a firm of same general nature, in same industry, or to related product areas.

If *any*, then corporations could combine for any purpose.

authorizing such holdings. It is possible the statutory law was silent, and court rulings permitted this.

*** Only two can consolidate, of similar type; purpose must be clearly and narrowly stated.

****Mining company can buy shares of railroad that carries its product.

smelted the same kinds of ores that the company extracted from the earth.[93] Perhaps most surprising was the broad language adopted by Kansas, a state that tended to be restrictive. Kansas had passed a law in1868 allowing any two telegraph companies to consolidate with shareholder approval. As of 1885, the same privileges were extended to all other corporations.[94]

New York was relatively active in liberalizing its merger provisions. In 1877 she allowed corporations in specified industries to consolidate when their purposes were substantially the same.[95] By 1884 New York set standardized procedures for purchasing other firms. Boards of directors were authorized to enter agreements to merge two or more manufacturing companies, and individual stockholders who disagreed with the valuation were given a procedure by which a court-appointed panel would adjudicate the value.[96] An 1888 New York provision authorized to directors to extend the range of corporate objects within one year of its charter, so long as the business was of the same general character.[97] When combined with the merger provisions, it allowed substantially greater flexibility than had existed before.

In this context, the New Jersey liberalizations on mergers must be viewed as less novel than has generally be considered. Over time the consolidation provisions were liberalized in many states. In a manner similar to New York, New Jersey

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93 1876 Minn. Stat. c. 28 § 8; Minn. Gen. Stat. c. 34 § 151 (1888).
94 1868 Kan. Sess. Laws (Act of Oct. 38 1868); 1885 Kan. Comp. Laws. c. 23 art 8 § 70; 1889 Kan. Gen. Stat. § 1160.
95 1877 N.Y. Laws c. 374. This law nevertheless limited the capital of the combined company to the limit prescribed by law.
96 1884 N.Y. Laws c. 367.
97 1888 N.Y. Laws c. 513.

allowed certain firms to consolidate in 1883, and extended this to other firms in 1888.[98] A more significant change came in 1893, when New Jersey allowed any two firms to consolidate.[99]

Inter-corporate Stock Holding. One of the most surprising findings of this research is that many states at a relatively early date allowed specified corporations to combine, even if the scope of the provisions were limited. This was also the case with intercorporate stock holding. Inter-corporate stock holding can provide for centralized management, but not to the degree of a integration via merger. A holding company has somewhat greater financial flexibility, such as permitting partial ownership and multiple tiering of assets. Table 3.12 displays the data.

Inter-corporate stock holding provisions have a slightly different genealogy than merger provisions. Firms were allowed to contract debts, and sometimes firms defaulted. States made provisions allowing firms to acquire the stock and bonds of other firms to satisfy debt obligations. In this regard, the genealogy is similar to real estate restrictions that allowed exceptions to satisfy debt obligations. Thus even restrictive Virginia, which prohibited the purchase of another corporation's stock, as early as early as 1849 did allow an exception for the satisfaction of judgments or debts.[100]

Other states also were strict. Pennsylvania in 1849 prohibited using capital stock to invest in other firms, before allowing investment of surplus funds in 1868.[101]

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[98] 1883 N.J. Laws p. 242; 1888 N.J. Laws p. 441; N.J. Gen. Stat. §§ 330-4, 346-50, (1896).
[99] 1893 N.J. Laws p. 121; N.J. Gen. Stat. § 273-80 (1896).
[100] Va. Code c. 56 § 3 (1849).
[101] 1849 Pa. Laws p. 565 § 8 (7 April); 1868 Pa. Laws p. 50 § 1 (31 March).

Table 3.12 The Right to Hold Corporate Stock

		1865	1876	1888	1900
North	Connecticut				any
	Delaware				any
	Illinois				Limited vert.
	Indiana				
	Maine				any
	Maryland				
	Massachusetts				
	Michigan	limited Vert.	limited/vert.	limited/vert	limited/vert.
	New Hampshire				
	New Jersey		*	horizontal	any
	New York		vertical	vertical	vert & horiz.
	Ohio		vertical	vertical	vertical
	Pennsylvania	prohibited	vertical	vertical	any
	Rhode Island				
	Vermont				
	Wisconsin			none/exception#	any
South	Alabama				limited##
	Arkansas				
	Florida				
	Georgia			prohibited**	prohibited**
	Kentucky				
	Louisiana				
	Mississippi				
	Missouri				
	North Carolina				
	Tennessee		vertical****	vertical****	vertical****
	Virginia	prohibited	prohibited	prohibited	prohibited
	West Virginia		vertical	vertical	vertical
West	California				
	Iowa				
	Kansas				
	Minnesota			vertical	vertical
	Nebraska				
	Oregon				
	Texas				

If blank, then the law was silent.

If *prohibited*, then a corporation could not merge or purchase shares in another company. Some states in this category did have exceptions for the satisfaction of debts.

If *vertical*, then a corporation could purchase companies that manufacture supplies for authorized business.

If *horizontal*, then a corporation could expand to related product areas.

If *any*, then corporations could combine for any purpose.

* New Jersey has a 1875 law that refers to holdings of stock, but I have been unable to find a law authorizing such holdings. Possibly the statutory law was silent, and court rulings permitted this.

** Georgia's 1877 Constitution forbade mergers; there is a case law regarding some exceptions.

****Mining company can buy shares of railroad that carries its product.

Wisconsin in 1878 forbade holding stock of other companies; in 1879, 1881 and 1882 it made exceptions for logging, and to allow firms to hold stock in firms that provided power for them.

Michigan as of 1867 allowed manufacturing companies to hold stock of salt companies.

As of 1855 Michigan allowed mining firms to invest in railroads that reach mines.

Alabama as of 1889 allowed land companies to invest in assets of other enterprises, and hold securities.

Georgia's 1877 Constitution prohibited the legislature from authorizing corporations to purchase shares or stock in any other corporation, or to make any contract which tended to lessen competition or encourage monopoly.[102]

Another purpose behind inter-corporate stock holding was to facilitate distribution. Michigan's early inter-corporate stock holding provisions (1857) permitted mining companies in the upper peninsula to hold stock in firms organized to construct canals, harbors, plank roads, or railroads that would provide transportation from the mines.[103] Ohio (1867) allowed railroads to purchase up to1/3 of the stock of grain elevators that the railroad serviced,[104] and by 1874 allowed mining and manufacturing firms to purchase stock of railroad or transportation they used.[105] There were similar provisions in Tennessee (1875) and West Virginia (1877, 1882).[106]

States also allowed vertical investment upstream to material procurement. New York (1876) amended its 1848 manufacturing law to permit a corporation to hold stock in the capital of any corporation that manufactured or used materials produced by that company.[107] Minnesota (1881) allowed mining firms to take and hold stock in any other corporation.[108] Wisconsin allowed mining and manufacturing firms to buy and hold stock in companies that generated electric light for them.[109] In West Virginia (1882) a manufacturing firm could purchase stock in a company that produced the

[102] Ga. Const. Of 1877 Art. 4 § II para. iv; Georgia Code p. 1304 (1882).
[103] 1855 Mich. Laws, p. 44; 1872 Mich. Comp. Laws § 2871.
[104] 1867 Ohio Laws v. 64 p. 85 § 4; Ohio Rev. Stat. § 3842 (1879).
[105] 1874 Ohio Laws v. 71 p. 69 § 2; Ohio Rev. Stat. § 3863 (1879).
[106] 1877 W. Va. Acts c. 8; W. Va. Code c. 53 § 1 (1899); Tenn. Code § 1692 (1884).
[107] 1876 N.Y. Laws 358, 458.
[108] Minn. Gen Laws. v. II c. 34 § 151 (1888).
[109] Wis. Rev. Stat. Supp. c. 86 § 1775 (1883).

materials used in its objects, with a vote of 2/3 of the shareholders.[110] New York (1890) also allowed firms to purchase stock in firms that supplied mining and manufacturing products needed for their business.[111]

The corporation code could also be used to direct investment in favored areas. Pennsylvania early on allowed firms to invest surplus funds in the public debt of the state of Pennsylvania, and of Philadelphia, as well as allowing investment in real estate and in securities.[112] Michigan pioneered provisions designed to encourage favored industries, by allowing all manufacturing firms to invest in the stock of salt manufacturing firms in 1867.[113] Wisconsin prohibited inter-corporate stock holding, but made exceptions for logging firms to buy and hold stock of other logging firms.[114] Pennsylvania (1887) allowed iron and steel firms to hold stock and bonds of other companies, and other companies to hold stocks and bonds of iron and steel firms.[115] New York rewrote its corporation law in 1890, with a separate section for stock corporations. There she allowed intercorporate stock holding, and allowed directors to vote the stock help by the company.[116]

In the years that followed, states began to seek to attract corporation charters. This was significant in that corporate capital was sought across state lines. New Jersey allowed corporations to purchase stocks and bonds of firms in other states in 1888, a

[110] W. Va. Code c. 53 § 1 (1899).
[111] 1890 N.Y. Laws c. 688 § 40.
[112] 1868 Pa. Laws p. 50 § 1 (31 March).
[113] Mich. Comp. Laws § 2852-4 (1872).
[114] Wis. Rev. Stat. Supp. c. 86 § 1775 (1883).
[115] 1887 Pa. Laws p. 411 § 1 (17 June).
[116] N.Y. Laws c 688 § 40.

law often credited with inaugurating the "race to the bottom."[117] Broadening to allow any corporation to hold stock in any other corporation was a significant move. New Jersey did so in 1893.[118] But even here, while New Jersey had broad language, she was not first. Wisconsin in 1891 allowed companies to hold stock in other corporations with the approval of ¾ of the shareholders in each corporation.[119] Other states followed over the next several years.[120] Full inter-corporate stock ownership was less radical than it would seem taken in isolation.

The New Jersey Law

It is clear from the evidence that the New Jersey enactments must be reinterpreted. This in turn requires that we make a closer examination of the timing and sequence of the New Jersey laws. In the 1890's New Jersey held the position as charter location of choice for the large corporation.[121] Its role is significant in that it was the first state that sought to attract charters from businesses that neither had nor

[117] N.J. Gen. Stat. § 345 (1896).

[118] N.J. Gen. Stat. §§ 260-2 (1896);

[119] 1891 Wisc. Acts c. 283; Wisc. Stat. c. 86. § 1775 (1911).

[120] Connecticut did not allow such corporations to vote the stock (1895 Conn. Acts 138; Conn. Gen. Stat. § 3324 (1902)). Delaware (1899): Del. Rev. Stat. § 1991 (1915); Pennsylvania: 1895 Pa. Laws p. 369 § 1 (26 June); 1895 Pa. Laws p. 370 § 1 (26 June).

[121] The fact of the New Jersey Laws are well rehearsed in the literature. See, notably, Chandler, *Visible Hand*, 319-20; Roy, *Socializing Capital,* 164-68; Rachel Rudmose Parker, *The Subnational State and Economic Organization: State Level Variation in Incorporation Law in the United States, 1880-1904*, (Ph.D. Dissertation, University of California, Los Angeles, 1993), 98-108. Charles McCurdy, "The *Knight* Sugar Decision of 1895 and the Modernization of American Corporation Law: 1869-1903," 53 *Business History Review*, 304-342; Christopher Grandy, *New Jersey and the Fiscal Origins of Modern American Corporation Law* (New York: Garland, 1993); Naomi Lamoreaux, *The Great Merger Movement in American Business*, New York: Cambridge University Press, 1985), 1; Horwitz, *Transformation of American Law*, 83. Lincoln Steffens wrote a muckraking piece for McClure's that has had much influence: Lincoln Steffens, "New Jersey: A Traitor State, Part II," *McClure's* 25: 41-55. An excellent history of the New Jersey corporation law up to 1875 is John W. Cadman, Jr., *The Corporation in New Jersey: Business and Politics, 1791-1875*, (Cambridge: Harvard University Press).

intended to have operations within the state. But its innovation was more of assembling provisions than creating them out of whole cloth.

The standard interpretation is that, beginning in the late 1880's, New Jersey accommodated pressure from New York corporate lawyers, and in particular William Nelson Cromwell (of the Sullivan and Cromwell law firm) for legal instruments that would allow corporate consolidation.[122] These were amendments to a conservative pro growth corporation law written in 1875. Cromwell's purpose was to sidestep anti-trust litigation against the Cotton Oil Trust brought by Louisiana. His solution was simply incorporate in a different state under different (specially created) laws. New Jersey followed with further clarifications and liberalizations in 1889, 1893, and 1896. The laws permitted corporations to purchase the stock in other corporations (and thus form holding companies if they so chose), and for corporations with no business interests in New Jersey to nonetheless take out charters there.[123] The New Jersey "revolution" inaugurated a "race to the bottom," as states sought the fees the came from granting charters.

The account of the New Jersey laws has been the subject of some misrepresentation. Lincoln Steffens wrote a classic muckraking account for McClure's in 1905, and famously referred to New Jersey as "The Traitor State" for its role in

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[122] See William G. Roy, *Socializing Capital: The Rise of the Large Corporation in America*, (Princeton, NJ: Princeton University Press, 1997), 201.

[123] Rachel Rudmose Parker, *The Subnational State and Economic Organization: State Level Variation in Incorporation Law in the United States, 1880-1904*, (Ph.D. Dissertation, University of California, Los Angeles, 1993), 98-108. Christopher Grandy, *New Jersey and the Fiscal Origins of Modern American Corporation Law*, (New York: Garland, 1993), 39-45. The New Jersey laws from 1888 to 1893 in regards to the formation of holding companies are also cited by James C. Bonbright and Gardiner C. Means, *The Holding Company: Its Public Significance and its Regulation*, (New York: McGraw Hill, 1932), p. 68.

inaugurating the movement towards liberal consolidation laws.[124] As Parker notes, Steffens got some of his history wrong. For example, he attributed changes in 1889 to Governor Leon Abbett (working with corporate attorney James Brooks Dill), although Abbett was not governor until later.[125] Others made less serious mistakes. Writing in 1930, Harold W. Stoke listed the major provisions of the New Jersey law of 1896 that he considered revolutionary. However, this law largely a re-codified changes from earlier in the decade.[126]

Two laws of significance passed in 1888. One included a provision that allowed corporations to purchase or dispose of stocks and bonds of other corporations, from other states "in the same manner and with all the rights, powers, and privileges of individual owners of the capital stock and bonds."[127] We have seen that while this was broader than other extant laws, it was not as radical as might otherwise be imagined.

The second contained a provision that allowed a certain classes of firms to consolidate: those engaged in the improvement or sale of lands, in the construction and maintenance of hotels and inns, and in transportation of goods or passengers by land or water.[128] Both Roy and Parker cite this law as a significant development.[129] Not only

[124] Lincoln Steffens, "New Jersey: A Traitor State, Part II," *McClure's* 25 (1905): 41-55.
[125] Parker, *Subnational State*, 98-101.
[126] Harold W. Stoke, "Economic Influences Upon the Corporation Laws of New Jersey," *Journal of Political Economy*, Vol. 38 , n. 5 (Oct., 1930), 572-3. The provisions he cites include allowing the formation of corporations for any legal purpose, allowing operations in any state or foreign country, allowing foreign corporations to hold property, granting permission to merge, granting consolidated companies to mortgage any property. He also notes the tax rate (1/10 of 1% up to stock value of $3 million, and $5 for each $100,000 above $5 million). Corporations had power to amend the charter regarding purposes, increase or decrease capital stock, change the location of the principle office, change common stock into preferred, and make other alterations with a vote of 2/3rds of the capital stock of the corporation
[127] 1888 N. J. Acts c. 249, N. J. Gen. Stat. § 345 (1896).
[128] 1888 N. J. Acts c. 294; N. J. Gen. Stat. § 346-50 (1896).
[129] Roy, *Socializing Capital,*166; Parker, *Subnational Sate,* 98-9. N.J. Gen. Stat. § 345-7 (1896).

was this not unique, it was in substance virtually identical to a New Jersey law from five years earlier that provided similar benefits for a different set of industries (an 1883 law that permitted consolidation for ferries, storehouses, and piers or for docks, yards, or buildings for livestock).[130]

An 1889 law allowed directors of corporations to purchase "mines, manufaturies (sic.) or other property necessary for their business, or the stock of any company or companies owning, mining, manufacturing or producing materials, or other property necessary for their business" and to issue stock for the purchases.[131] This both gave power to directors to make fundamental decisions, and formalized weaker language from 1888.

More changes followed. In 1891and 1892 New Jersey allowed the directors to alter the capital stock, and in 1892 allowed stockholders to amend articles (with approval of the Governor), and to do business in or out of the state, so long as an office was kept in the state.[132] This office need not be the main headquarters, and many firms would end up sharing space across the river from New York. These changes are usually missed in the literature, but other states had long permitted out of state operations.

In 1893 New Jersey allowed firms to alter the line of business they were engaged in. It broadened language to allow any corporation to purchase, hold, or convey shares in any other firm, and to vote the shares of the stock. This meant that a

[130] 1896 N.J. Gen. Stat. §. 330-1.
[131] 1889 N. J. Acts c. 265; N.J. Gen. Stat. § 213 (1896).
[132] 1891 N. J. Acts c.177; 1892 N. J. Acts c. 2, 11, 56; N. J. Gen. Stat. §§ 236, 240-244, 366 (1896).

company did not have to be engaged in a particular line of business to purchase shares, but could act as a company whose primary purpose was to hold stocks of other corporations. A new law also allowed any two businesses to consolidate.[133] However, as we have just seen, intercorporate stock ownership was not unique: several other states allowed limited versions of this. And Michigan's 1891 permissiveness in this regard demonstrates that New Jersey was not alone in relaxing her law. The patchwork of New Jersey laws was rewritten and codified by a major revision of the state's corporation laws in 1896.[134] Such a re-codification was also not unique. New York had done so in 1890 and in 1892.[135]

Roy and Parker each note the lack of fanfare that followed the New Jersey 1888 and 1889 laws.[136] I believe that this is because this particular law was unexceptional in comparison to other laws passed before within New Jersey, and in other states. The New Jersey liberalizations were an inflection point in a widespread phenomenon, not a clean break with the past.

Changes in corporation law in the late 1880's and early 1890's were far less radical than they would have seemed twenty or thirty years earlier. Other states also had also developed their corporation laws, and included liberal provisions that antedated the New Jersey laws. In fact, virtually every provision of the New Jersey laws existed somewhere else at an earlier time. However, these provisions did not exist in the same place at the same time.

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133 1893 N. J. Acts c. 67, 171, 254 § 10;1896 Gen. Stat. §§260-62, 274, 373-80.
134 1896 N. J. Acts c. 185.
135 1890 N.Y. Laws c. 567; 1892 N.Y Laws c. 687.
136 Roy, *Socializing Capital*, 165; Parker, *Subnational State*, 102.

New Jersey accelerated a process that was already in motion. She did not so much as initiate a "race to the bottom" as win that race. Her innovation was to assemble already existing provisions into a coherent and thoroughly liberal package. This is an important innovation in its own right. Nevertheless, these innovations were an inflection point in a widespread phenomenon, not a clean break with the past.

Capital Concentration

It remains to determine the causes of the relaxation of charter law. One way to get at this is to compare the various state policies in 1888, the year that New Jersey began its liberalizations. This is shown in table 3.13. States coded as permissive are marked with an *X*; others are left blank. Keep in mind that this is a very broad brush of the various policies. Nevertheless, every state had at least one restrictive policy other than director liability. These states used different combinations of laws to restrain corporations, but all had some restrictive policy in place. But also note that every policy that existed in New Jersey existed somewhere else at the same time. Again, it was the combination of permissive policies that was novel.

There is no obvious pattern that appears on its own to explain within-sectional variation. However, we can test the data according level of industrial development, amount of agricultural output, and profile of capital concentration.

Because the date as presented in Table 13.3 is a rather crude snapshot, I create more nuanced measure with a series of threshold tests. These tests allow us to measure nuances within each category. For each category in the table, I construct three

Table 3.13 Summary of Policies in 1888

	State	Objects	Any Lawful	Term	Cap Limit	Real Estate	Pref Stock	Share-holder Liability	Director Liability	Merge	Holding Company
North	Connecticut		X	X	X	X					
	Delaware				X	X					
	Illinois	X	X	X	X	X				X	
	Indiana				X	X			X		
	Maine		X	X				X			
	Maryland	X			X	X	X	X		X	
	Massachusetts			X		X					
	Michigan					X				X	
	New Hampshire			X	X	X		X			
	New Jersey	X	X	X	X	X	X	X		X	X
	New York	X	X	X		X	X	X		X	
	Ohio	X	X	X	X	X	X			X	
	Pennsylvania			X			X				X
	Rhode Island			X	X	X		X			
	Vermont		X	X		X					
	Wisconsin			X		??					X
South	Alabama			X	X	X	X	X	X	X	
	Arkansas			X		X			X		
	Florida		X		X	X		X			
	Georgia		X		X	X	X	X	X		
	Kentucky		X	X	X	X		X	X		
	Louisiana		X	X	X	X		X	X	X	
	Mississippi			X	X						
	Missouri		X	X	X	X	X	X		X	
	North Carolina			X	X						
	Tennessee	X			X	X					X
	Virginia		X			X		X			
	West Virginia	X		X	X	X	X	X			X
West	California		X	X	X	X	X	X			
	Iowa		X		X	X		X	X		
	Kansas				X	X				X	
	Minnesota			X	X	X	X	X		X	X
	Nebraska		X		X	X			X		
	Oregon		X			X		X			
	Texas			X	X	X		X			

X is coded for permissive; restrictive or other are left blank

Objects: States silent, permitting no expansion of objects, or requireing changes to the charter are coded as restrictive, others are permissive

Any Law: States permitting incorporation for any legal purpose are coded as permisseve, others as restrictive.

Term: States with a maximum term under 50 years are restrictive, others are permissive
Cap limit: States with a maximum on size are coded as restrictive, others are permissive
Real Estate: States with a hard limit on real estate holdings are restrictive, others are permissive.
Preferred Stock: States that provided for preferred stock are permissive, others are restrictive.
Shareholder Liability: States with labor or extra liability are coded as restrictive, others are permissive.
Director Liability: states with some form of director liability are coded as restrictive
Holding Company: states with any form of corporate stockholding are coded as permissive, others are restrictive.
Merge: states permitting some any form of merger are coded as permissive, other are restrictive.

threshold tests, each more permissive than the next. In each test, a law is categorized as 0 or 1, with 1 indicating the more permissive law. For example, in the area of allowing corporations to expand their purposes, the three tests are: 1) Does a state allow expansion of purposes by a altering the charter? 2) Does the state permit either vertical or horizontal integration? and 3) Does the state allow corporations to expand to any purpose? These questions test for increasing levels of permissiveness. In all cases, if the answer is no, the state is scored as 0, and if the answer is yes, the state is scored as 1. Thus a state that allows no expansion of objects will not meet any of the thresholds and is scored as 0 for all three tests. A state that allows changes to the charter to allow expansion of objects receives a score of 1 in the first test, but a score of 0 for the next two texts. A state that allows either industrial or vertical expansion, but not to any purpose will receive a score of 1 on each of the first two tests, but a 0 on the last test. Finally, a state that allows expansion to any objects will receive a score of 3 on all three tests. All together, I create a scale for 8 of the areas where I can create three such tests. One area, of director liability, is dichotomous, so I merely create one dichotomous test for it. The end result is a dependent variable ranging from 0-25, with 0 being most restrictive, and 25 most permissive. Table 3.14 displays the tests.

I wish to test for the significance of capital concentration as a cause of liberal corporation law. The Census of Manufactures of 1905 contains data on the composition of the manufacturing sector.[137] This included a measure of the total amount of manufacturing capital in each state, and the percentage in firms of different

[137] United States Bureau of the Census, Census of Manufactures: 1905 U.S., Bulletin 57, (Washington: Government Printing Office, 1906), Table 4.

Table 3.14 Construction of Threshold Values

Table 3.2 Expansion of Objects
2a Charter or more easilly no = 0, yes = 1
2b Vertical or Industrial, (or both), or more easily no = 0, yes = 1
2c any no = 0, yes = 1

Table 3.4 Maximum term of existence
4a 20 or more = 1, if not = 0
4b 50 or more = 1, if not = 0
4c perpetual = 1, if not = 0

Table 3.5 Maximum Level of Capitalization
5a No limit = 1, otherwise = 0
5b Limit of 10 Million or less = 0, otherwise = 1
5c Limit of 2 million or less = 0, otherwise = 1

Table 3.6 Limits on Real Estate
6a none = 1, otherwise = 0
6b soft or greater = 0, otherwise = 1
6c hard or greater = 0, otherwise = 1

Table 3.7 Power to Alter Capital Stock
7a directors = 1, otherwise = 0
7b majority or more = 0, otherwise = 1
7c supermajority or more= 0, otherwise = 1

Table 3.8 Power to Issue Preferred Stock
6a 3.8 yes = 1, no=0 (dichotomous variable)

Table 3.9 Shareholder Liability
9a Extra (not including Labor) = 0, otherwise = 1
9b Labor (including extra) = 0, no restrictions on labor = 1
9c Limited = 1, more than limited = 0

Table 3.11 Merge
11a vert. = 1, others = 0
11b horiz = 1, others = 0
11c any = 1, others = 0

Table 3.12 Holding company
12a vertical = 1, otherwise = 0
12b horiz. = 1. otherwise = 0
12c any (includes vertical and horizontal) = 1, otherwise = 0

Table 3.10 (Director Liability) is left out due to lack of variation sizes. It divided firm size into five categories: under $5000, from $5000 up to $20,000, from $20,000 up to $100,000, from $100,000 up to $100,000, and $1,000,000 and over. I created an index of capital concentration by simply recording the percentage of manufacturing capital in each state controlled by firms valued at over $1,000,000. This statistic ranged from 0% (no large firm) to 57% (Kansas). A state could have a high concentration of capital by not having extensive manufacturing but having a few large manufacturers, or it could be well developed, with lots of small sized manufactures. I control for three other variables. These are per-capita value added in manufacturing, (a proxy for industrial development), per capita value of agricultural products (as a measure of the influence of agriculture), and the ratio of these last two variables. These are derived from the 1890 census.[138]

I test this data using a standard OLS multiple regression. The results are displayed in Table 3.15. The degree of capital concentration is both positive and statistically significant at the .05 level. This is as expected. Value of agriculture is negative and statistically significant at the .05 level. This makes sense: states dominated by agriculture were more likely to resist liberal corporation law. Per-capital value added in manufacturing is negative (the wrong direction) and not statistically significant. While I would have expected a positive result, the lack of significance fits with my theory. I expect states with high levels of industrial development, but low concentration of capital to resist liberal laws. Finally, the ratio of per-capita value-added in manufacturing to per capita-value of agriculture is negative, but not

[138] These are derived from *Historical, Demographic, Economic, and Social Data: The United States, 1790-1970*; Inter-University Consortium for Political and Social Research.

Table 3.15 Liberal Incorporation Law—OLS Model

Capital Concentration	.102**
	(.043)
Per-Capita Value-Added in Manufacturing	-.027
	(.024)
Per-Capita Value of Agriculture	-.109**
	(.051)
Ratio of Manufact. to Agric.	-.133
	(.276)
Constant	11.31***
	(2.31)
	F (4, 30) = 2.09
	Prob > F = .13
Standard errors in parentheses	SEE=3.38
**significant at P < .05	adj R^2 = .114
***significant at P < .01	N=35

Table 3.16 Liberal Incorporation Law—Extended Beta Binomial Model

Capital Concentration	.012***
	(.004)
Per-Capita Value-Added in Manufacturing	-.003
	(.002)
Per-Capita Value of Agriculture	-.012**
	(.006)
Ratio of Manufact. to Agric.	-.015
	(.029)
Constant equation 1	-.088
	(.240)
Constant equation 2	.034*
	(.018)
Standard errors in parentheses	Wald Chi^2 = 9.64
*significant at P < .10	Prob > Chi^2 = .047
**significant at P < .05	Log Likelihood = -89.07
***significant at P < .01	N=35

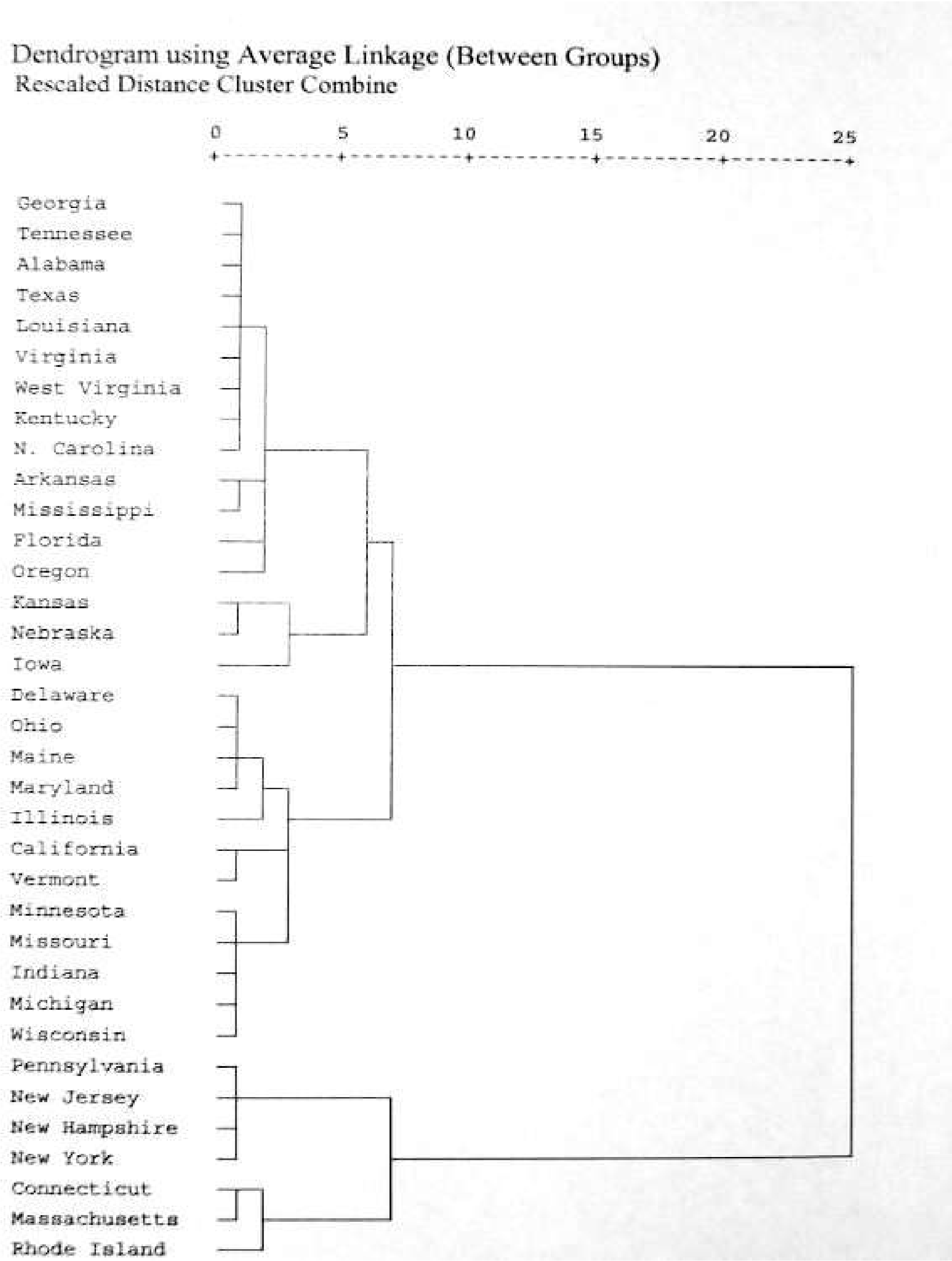
significant. A mere ratio of industrial development to agricultural development does not explain the permissiveness of corporation law. The model as a whole approaches, but does not reach standard definitions of statistical significance.

The dependent variable in this model is constructed from a series of dichotomous tests. It is both discrete (no interval values other than the discrete numbers) and limited (to between 0 and 25.) The appropriate procedure for a model with discrete dependent variables is an extended beta binomial model.[139] The regression used above can be justified because the as the range of the dependent variable increases, the extended beta binomial model approaches standard OLS regression. Nevertheless, it is useful to check the reliability of the OLS model with the extended beta binomial. The results are presented in Table 3.16. There we see a similar patter of direction and significance. The model as whole is more robust, with a statistical significance at the .05 level.

Another way to analyze the data is to use a hierarchical cluster analysis. This groups the states according to overall similarity of data characteristics. The groupings can be graphically displayed with a dendrogram, shown in Figure 3.1. Similar states are clustered together. The greater the magnitude of the bracket, the more dissimilar the groupings. In this analysis the core of the metropole is clearly distinguished from the other states. Thus Pennsylvania, New Jersey, New Hampshire, and New York are grouped together, and Connecticut, Massachusetts and Rhode Island are clustered nearby (New Hampshire is the one unexpected case in this grouping.) The Southern

[139] See Gary King, *Unifying Political Methodology: The Likelihood Theory of Statistical Inference* (New York: Cambridge University Press, 1989).

Figure 3.1 Hierarchical Cluster Analysis



states are largely grouped together, as are the states of the Midwest. The place of Ohio is quite interesting; it is grouped with states at the periphery of the metropole, rather than in the industrial core. This is consistent with its restrictive tradition, including double liability. West Virginia sought to attract industrial enterprises, but its grouping with Southern states indicates the significance of the demographic and industrial characteristics that presented obstacles to that project. California is grouped with the Midwestern states of Minnesota, Missouri, Indiana, Michigan, and Wisconsin. San Francisco was a metropole of its own, but its location in this analysis indicates that California's industrial characteristics were tempered with a decidedly agricultural tint. The Western metropole at that time looked nothing like the Eastern metropole. Finally, there is no pattern at this time that distinguished the small states from the large states. New Jersey is grouped in the metropole, as is Rhode Island, and Delaware is still a sleepy outpost at the metropole's edge.

The pattern is highly suggestive for students of economic development. Rostow's take-off theory suggests an organic process of economic growth. Small manufacturing, along with cultural acceptance and appropriate education set the stage for a take-off towards rapid industrial development.[140] From small firms grow large firms. This research indicates a more complicated process: states with extensive small manufacturing tend to resist laws that encourage the concentration evident in the large industrial corporation. Corporate development in America required sister states with distinct legal sovereignty that subverted the will of states with extensive small

[140] W. W. Rostow, *The Process of Economic Growth., 2nd ed.* (New York: Norton, 1962).

manufacturing. It is this characteristic that separates New Jersey from Connecticut. Both states were near Manhattan, and thus both might be considered logical choices for liberal incorporation law. But Connecticut, like New York and Massachusetts, has extensive small manufacturing. It was not fertile ground for liberal incorporation law. New Jersey, on the other hand, was.

The full relaxing of incorporation law required an evolution in mentalities over what was acceptable. For this reason, the alteration in the New Jersey law was prefigured by evolutionary change in the preceding quarter century, at least. By the end of the century, there was a far more extensive and specialized code specifically regarding business corporations than existed before. These changes occurred not in a vacuum, but in industrial settings that varied from state to state.

Chapter 4

Corporate Theory and its Tradition in American Politics

America is a nation founded upon individual rights, and the legal system is designed to protect those rights. In this context the status of corporations presents a puzzle. Corporations are obviously not "natural" persons. Yet precisely how they should be classified and treated has been a source of on going legal debate with real import. Is the corporation an entity in its own right, or is it reducible to the shareholders who own it? If the former, what rights do corporations have? What protections for individuals ought to be applied to corporations in this circumstance? If the latter, then corporate rights must also reduce to the shareholders. Yet how do we assign liability of a group to its individual members to cover the corporation's obligations? Existing scholarship has addressed these questions by an examination of decisions by the bench, and by doctrine advocated at the bar. I submit that we must also examine the statutory record in order to understand both how the law was formed, and why it changed.

The existing literature shows that early nineteenth century legal doctrine treated the corporation as an artificial entity. I shall argue that this theory was used to justify the granting corporate rights. By the early twentieth century this was the artificial entity theory had become discredited. Changes in procedures from special legislative acts to general laws of incorporation placed stresses on the formalist construction of the corporation as an artificial entity, because initiative for corporate creation passed to private individuals rather than the state. The advent of new technologies, the spread of railroads, and the rise of corporations also served to challenge older, static, conceptions of property. Industrial development created new forms of intangible property that the old, formalist legal doctrine was unable to adequately accommodate. The greater size with control centered in management of new corporations was also unanticipated and thus unaccounted for by the older theories. Changes in property relations, according to Morton Horwitz, led to a crisis of orthodox modes of legal thought, and thus to the reconstruction of legal doctrine.[1] The nature of the corporation was at the center of this transformation. The doctrinal solution that gained credence in the early twentieth century treated the corporation as a "natural entity."

I argue that the same pressures impacted state legislators; the crisis of legal orthodoxy thus impacted state statutory law. The reaction of the state legislators to changes during industrialization these is a largely unrecognized element in the creation of the "American system" of corporation law that dominated the twentieth century. Legislators responded to pressures both to expand their economies and yet control corporate excesses to the benefit of the citizenry.

The corporate rights of the late nineteenth century were constructed in the states under the artificial entity theory, and this view was used to justify statutory regulation. At times legislators mixed the artificial entity with the elements of a

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[1] In particular, Morton Horwitz identifies a "Crisis of Legal Orthodoxy" that propelled changes in legal thought. Morton J. Horwitz, *The Transformation of American Law, 1870-1960: The Crisis of Legal Orthodoxy* (New York: Oxford University Press, 1992). See also William M. Wiecek, *The Lost World of Classical Legal Thought: Law and Ideology in America*, 1886-1937 (New York: Oxford University Press, 1998); David Millon, "Theories of the Corporation," *Duke Law Journal*, (1990), 201-265.

partnership theory. Nevertheless, the extant understandings of the corporation all pointed to the legitimate role of the state to regulate the properties and extent of activities of corporations. The content of corporate rights at the turn of the 20th century was built on this understanding.

The pervasive practice of corporate creation adds a layer to our understanding to the operation of ideology in the American political economy. America has a liberal tradition based on individual rights. Rogers Smith asserts that ascriptive traditions have existed alongside the liberal tradition.[2] The pervasive practice of corporate construction suggests an additional, corporate tradition. This American tradition of corporate powers was built in statutes as well as at the bar and bench.

Legal Theory and the Artificial Entity

The American legal system is founded on individual rights. The privileging of the individual in America is derived at least in part from Lockianism, which regards individual rights as pre-political. Because the rights are pre-political, they may not be violated or abridged by the state.[3] Since the corporation is not a natural person, it has presented problems for the legal system from the outset. Pre-political rights can only

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2 Rogers Smith, *Civic Ideals: Conflicting Views of Citizenship in U.S. History* (New Haven: Yale University Press, 1997).

3 In this view the Bill of Rights is not a granting of rights, but codification of naturally existing individual rights. The assertion of the pre-political character of individual rights raises the question of the need for a bill of rights. In one view the enumeration of rights is a positive protection for individuals. In the other view there is no need to enumerate rights that individuals already have. Furthermore, any enumeration of individual rights can never be exhaustive: even in stating great principles, there will be some individual rights that are excluded. By lack of foresight, the exclusion of some principles from an enumeration may prejudice the state against enforcing rights that might well have been considered as important as those enumerated by those who framed the extant provisions.

be applied to corporations if the corporation has pre-political status, or if it has rights as a result of the pre-political rights of the individuals who compose it. If it is to be treated as an entity, the question then arises: what constitutional rights and protections does the corporation have? What logic could properly capture the problems the corporation posed for questions of legal standing, enforceability of contracts, or liability for damages by corporate agents? This question ultimately is brought to bear on what protections in the U.S. Constitution, if any, apply to corporations. Obviously, if protections for individuals can serve as justifications for the protection of corporations, a host of legal doctrine that has been settled for the former can be applied to the latter.[4]

Two theories of the corporation contended in the nineteenth century, an artificial entity theory and a shareholder theory. Under the artificial entity theory, the charter of a corporation created an entity distinct from its shareholders, existing in contemplation of the law. The corporation in this view is created by grants from the sovereign. It has an independent existence from its members. Under the shareholder theory, the corporation was merely an vehicle that represented the shareholders. It could thus be reduced to its shareholders for the purpose of rights, and had no independent existence in and of itself. Thus the corporation was really a partnership.

This debate over the nature of the corporate entity dates from at least the early 17th century. Sir Edward Coke addressed the issue of legal entity in the case of

4 Horwitz, *Transformation of American Law*, 65-107; J. Willard Hurst, *The Legitimacy of the Business Corporation* (Charlottesville: University of Virginia Press, 1970). Millon, "Theories of the Corporation," 204-220.

Sutton's Hospital (1612). He noted that the hospital corporation at issue was an entity granted by the Sovereign. Further, the corporation by necessity existed prior to the license to create a hospital. The hospital corporation was, thus, separate from a mere license to build and operate the hospital. The King's grant resulted in the "creation of a body Politick by way of Incorporation, to have perpetual succession, to perfect and perpetuate so pious and charitable a work."[5] The charter itself stated that to provide for the hospital's effectiveness "That the said persons &c. be one body corporate and Politick, to have perpetual succession to endure for ever: We do by these presents for ever hereafter fully and really incorporate, &c. to have capacity and ability to take &c."[6] Note that the purpose was to promote a more effective endeavor than would otherwise be the case. Note also that the sovereign creates a "political body," with vested rights.

Early American corporations were founded on a similar premise. Alexander Hamilton was an astute student of the British system of incorporation, including the incorporation of the Bank of England in 1694.[7] In his 1791 memo to George Washington on the appropriateness of chartering a bank Hamilton emphasized that a charter gave "*legal* or *artificial* capacity to one or more persons, distinct from the natural."[8] Hamilton's interpretation was not materially different from Coke's. Both

5 *The Case of Sutton's Hospital*, Michaelmas Term, 10 James I (1612) [First Published in Reports, vol. 10, page 23 a], 25 a- 26 b; Quoted from Steven Shepard, ed., *The Selected Writing of Sir Edward Coke*, Vol. I (Indianapolis, Indiana: Liberty Fund, 2003), p 354.

6 Ibid., 355-56.

7 See Ron Chernow, *Alexander Hamilton* (New York: The Penguin Press, 2004), 156-157, 295-301.

8 Alexander Hamilton, "Opinion on the Constitutionality of an Act to Establish a Bank", quoted in Brest, Levinson, Balkin and Amar, *Processes of Constitutional Decisionmaking: Cases and Materials, 4th Ed*. (New York: Aspen Law & Business, 2000) Emphasis in original.

justified corporations as artificial entities that furthered the public good.

The uncertainly in the law over how to treat the corporation was evident in *Bank of the U.S. v. Deveaux* (1809).[9] There the court ruled that for purposes of jurisdiction the corporation was an entity distinct from its shareholders. Chief Justice Marshall noted that the corporation was "defined as a mere creature of law, invisible, intangible, and incorporeal."[10] Statutory language, therefore, must be explicit in order for the corporation to have standing: it could not have standing as a matter of mere existence. The question in this case was whether the owners of the corporation, as citizens of diverse states, had the right to sue in federal court. Despite his pronouncement of the corporation as an entity, Marshall nevertheless also noted that corporations "have been included within terms of description appropriated to real persons."[11] Thus on the question of jurisdiction the court should "look to the character of the individuals who compose the corporation."[12] This decision treated the corporation as an artificial entity, yet for purposes of jurisdiction reduced the corporation to its members. However, it left open the question of how the law would rule on corporate personality when substantive issues were at stake.[13]

The nature of the corporation in regards to substantive issues came to a head in the next decade, in the *Dartmouth College* (1819) case.[14] At issue was whether the

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9 *The Bank of the United States v. Deveaux et al.*, 5 Cranch 61 (1809).
10 Ibid., 91.
11 Ibid.
12 Ibid., 91-92.
13 This, we might surmise, is consistent with judicial practice of not answering a question that need not be answered in order to settle the case at hand, thus allowing precedent to build as circumstances warrant.
14 *Trustees of Dartmouth College v. Woodward*, 17 U.S. 518 (1819).

grant of a charter by the state could be revoked. In ruling that the state could not revoke a charter, Marshall provided a clear statement of the artificial entity theory:

> A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression may be allowed, individuality; properties by which a perpetual succession of many persons are considered as the same, and may act as a single individual. They enable a corporation to manage its own affairs and to hold property without the perplexing intricacies, the hazardous and endless necessity of perpetual conveyances for the purpose of transmitting it from hand to hand. It is chiefly for the purpose of clothing bodies of men, in succession, with these qualities and capacities that corporations were invented and are in use.[15]

The ruling in *Dartmouth* that grants made by the sovereign to a corporate entity could not be taken back by the state was substantially modified by the Taney court in the *Charles River Bridge* case (1837).[16] There, the state had chartered a corporation, granting it the right to build a bridge and charge tolls for use of the bridge. The court ruled that, in the absence of an explicit provision to the contrary in the Charles River Bridge charter, the state could charter a nearby competing bridge without violating the charter agreement of the Charles River Bridge. This altered the ruling from *Dartmouth College*, because in the absence of an explicit provision to the contrary, a grant of monopoly is not exclusive.[17]

Despite these significant disagreements with Marshall over the state's right to

[15] Ibid.

[16] *Charles River Bridge v. Warren Bridge* 36 U.S. 420 (1837).

[17] As a result of *Dartmouth College* states wrote provisions in their corporation law allowing revocation or alteration of charters. Only corporation chartered before such acts were exempt from this. However, states also wrote provisions requiring that any existing corporation that sought an addition privilege must accept an amendment that made the charter subject to amendment, alteration, or revocation.

issue charters that impacted an existing chartered corporation, both Taney and Marshall were in agreement as to the proper characterization of corporation as an artificial entity. This is evident in Taney's rejection of the of the partnership theory in *Bank of Augusta v. Earle* (1839).

> Whenever a corporation makes a contract it is the contract of the legal entity; of the artificial being created by the charter; and not the contract of the individual members. The only rights it can claim are the rights which are given to it in that character, and not the right which belong to its members as citizens of a state.[18]

Taney further noted that to reduce the corporation to a partnership of the stockholders would have the effect rendering the stockholders fully liable for the debts of the corporation.

Thus, the artificial entity theory of the corporation was predicated on the corporation as a grant of privileges from the state. State legislatures made individual grants to applicants, and passed individual charters by legislative enactment. Originally these were for public purposes: to build a road or a bridge, or to provide some other needed public service. Over the course of the nineteenth century the purposes for which corporations were granted charters expanded. By the middle of the century corporations were chartered for a wide variety of profit making motive, often with no discernible “public” purpose. A canal or railroad corporations did have a public purpose, while a manufacturing firm did not.

[18] *Bank of Augusta v. Earle,* 38 U.S. 519.

The Context of the Crisis of Legal Orthodoxy

Morton Horwitz argues that the late nineteenth century witnessed a crisis in orthodox conceptions of the law. Classical legal thought was based on formalistic reasoning. This reasoning sought to render the state as a neutral arbiter of claims on wealth. It sought to categorical, syllogistic reasoning based on absolute principles. Categorical reasoning conceptualized events as subject in legal decisions to "bright-line classifications" characterized by certain logical deduction.[19] It sought a complete and closed system of legal reasoning to render decisions based on neutral principles. This would, among other things, avoid consequentialist, results oriented decisions. Such a mode of reasoning would avoid populistic redistribution of wealth.

The theoretical foundation of legal formalism came under an assault due to the exigencies of an expanding economy. The technological innovations of the industrial age placed stresses on formalistic legal relations. Most economic activity centered on corporations. As corporations grew, they drew more and more contracts. With their greater size, actions of corporate agents became ubiquitous. Many actions of negligence resulted from the economic activities of agents in the name of the corporate entity. Formalist classical legal doctrines were ill suited to the new industrial conditions. This was particularly the case in the areas of contracts, torts, and agency. The result was a casting about for a new set of legal theories.

At the middle of the century the prevailing theory of contract law was based upon a meeting of the minds between the parties to a given contract. The task of the

[19] Horwitz, *Transformation of American Law,* 17. See also Wiecek, *The Lost World of Classical Legal Thought*.

law was to ascertain what was meant by each party to the contract, and to render judgment accordingly. This was termed the "will" theory of contracts. The problem with such a theory is that juries were directed to search for the "will" of each of the parties, and the results often seemed arbitrary and unpredictable. Following the Civil War, judges began to search for an standard that would be more predictable. An "objective" standard of contact invoked expected community standards of the meaning of the terms of the contract. This was part of a wider ranging effort to provide neutral standards. Objectivism was part of a movement away from a "natural rights" philosophy with roots in the founding generation of the American political system.[20]

Classical legal thought sought to limit civil torts to circumstances where "objective causation" could be determined. Thus "proximate" causes and empirical "chains of causation" were needed in order to assign liability. The task of judges was to ascertain the single cause of empirical chain of events that led to a harm.[21] This standard survived the 19th century, to come under attack by legal realists in the early 20th century. The challenge came in the wake of challenges to the notion of simple causation in natural sciences. Legal scholars began to recognize that there were often multiple causes to events, and that no one by itself would cause the event. The result of multiple causation was that there could be "no necessary connection between particular causes and effects," and assignment of blame must instead depend upon statistical correlation between a purported cause and its result.[22] Or, as Oliver Wendall

[20] Horwitz, *Transformation of American Law*, 33-36
[21] Ibid., 51-55.
[22] Ibid., 59.

Holmes famously noted, “the man of the future is the man of statistics and the master of economics.”[23]

An element of the law of agency is the extent of control and the degree of liability a principal has over his agent. With the rise of large corporate organizations, the question of principal responsibility for agents conduct took on greater importance. “There was a trade-off between, on the one hand, corporate control of the behavior of employees and, on the other, the level of confidence that third parties would have in the legitimate authority of these employees.”[24] Could an agent bind his principal if, for example, the agent exceeded his authority? How would a third party know this, and what sort of contracts would be held to be void? In the late nineteenth century courts promulgated a doctrine of “apparent authority,” that an agent need not have actual authority if it was reasonable for a third party to believe that he did [25] This doctrine was at odds with orthodox legal thinking. Under such theory there could be no “meeting of the minds” central to a “will” theory of contract.

The agency problem raised the issue of corporate “will.” What was the nature of the authority of the corporation, and how could a court determine what the “will” of a corporation was in delegating authority to its agents? How could an artificial entity

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[23] Oliver Wendall Holmes, “The Path of the Law,” in *Collected Legal Papers* (Harcourt, Brace, and Howe, 1920), 187. Quoted in Horwitz, *Transformation of American Law*, 59.

[24] Horwitz, *Transformation of American Law*, 39-40.

[25] Horwitz contends that there was a bifurcation between theory of agency in the late nineteenth century in legal treatises, on the one hand, and in judicial decision, on the other. The former theorized that a principal could only be liable for what he actually authorized, which was based on subjective will. Thus an agent that misrepresented himself was liable for damages, and the principal was not. The latter contended that an agents contracts were binding on the principal if the third party could have reasonably expected the agent to have authority to execute a contract, whether or not the agent did in fact have that authority. Ibid., 40-45.

have a “will”? Was the will of the corporation the will it its shareholders voting in unanimity? Or voting as a majority? In Horwitz's terms, “The corporate form thus forced judges to objectivize legal concepts, to look for the reliance of a “reasonable person” rather than the actual subjective (or particular) command of a principal.”[26] Thus in agency, as in contracts and torts, the development of the corporation placed stresses on orthodox legal theory, eventually leading to the realist critique. Corporate development thus impacted a wide array of legal doctrine.

The late nineteenth century was a time of massive change in immigration, labor unrest, depression, and market cartelization. The disruptive changes of this period induced Oliver Wendall Holmes to question subjective standards. [27] In the advent of corporate concentration, the existing natural rights doctrine could not provide unequivocal distinctions of property rights. New technological advances led to conflict over the extent of property rights and to new claims to abstract property. Horwitz argues that “the shift from landed to intangible property exposed the socially created and hence disputable character of all property boundaries.”[28]

The Crisis of the Artificial Entity Theory in the Late Nineteenth Century

There is a general agreement among scholars that the artificial entity theory of the corporation came under stress in the second half of the 19th century. States during this period changed their means of creating charters from special legislative acts to

[26] Ibid., 48.
[27] Ibid., 138.
[28] Ibid., 139.

general laws. Whereas charters made by special acts of legislatures were a grant by the sovereign, general laws of incorporation made charters available to all applicants that met a predetermined set of criteria. Thus the corporation was no longer a result of a "grant" by the state, but rather the initiative for corporate creation resided in the actions of private individuals. According to Horwitz, general laws of incorporation gradually caused the demise of the grant theory.[29]

With the crisis of the artificial entity theory, some legal theorists sought to articulate a "partnership theory" whereby the corporation was merely the sum total of its shareholders.[30] As foreseen by Taney in *Bank of Augusta v. Earle*,[31] this led to a concern over liability. If members were partners, then they by rights ought to be liable for debts and for negligent or criminal actions of the corporation. But most states had full limited liability, double liability, or limited liability plus liability for wages of labor. This would not be consistent with the partnership theory. The partnership theory ran into another obstacle. In small corporations owners and the managers were typically one and the same. In larger corporations, no one individual shareholder had effective control over the corporation. As corporations grew in size, management became separated from ownership.[32] The growth of the large corporation in the late nineteenth century forced legal writers to rethink the place of the large corporation. A

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29 Ibid., 73. See also Millon, "Theories of the Corporation," 206-211; and William W. Bratton, Jr., "The Nexus of Contracts" Corporation: A Critical Appraisal, *Cornell Law Review*, vol. 74 (1989), 434-36.

30 The first advocate of this was Victor Morawitz in *Treatise on the Law of Private Corporations, 1st ed.* (New York: Little, Brown, 1882), vol. 1, iii. See. Horwitz, *Transformation of American Law*, 90.

31 *Bank of Augusta v. Earle,* 38 U.S. 519.

32 Adolf A. Berle, Jr., and Gardiner C. Means. *The Modern Corporation and Private Property* (New York: Macmillan, 1932.)

partnership theory of the corporation is inconsistent when the management, rather than shareholders, has control of the corporation. Further, a partnership theory would tend to require unanimous vote of the shareholders in order to effect major transactions. This was impractical; many state statutes and court decisions set majority rule as an acceptable standard.

Despite its impracticalities, Horwitz contends that advocates of the partnership theory paved the way for a third theory, the "natural entity theory," by pointing out the flaws of the artificial entity theory. The natural entity theory would find adherents early in the 20th century. It rose out of German idealism, which sought to assign natural rights to groups as well as to individuals. In the years surrounding 1900 Ernst Freund and Frederic Maitland each began to advance the ideas developed by Otto Gierke in Germany that the corporation was a "real" entity."[33] They argued that the corporation was a natural part of the political economy. Because general laws were available to all applicants (as opposed to the requirement of legislative acts to create a corporation), corporation arose from the actions of private persons. Further, concentration was an inevitable and natural part of more advanced economic activity that led to increased efficiency. The corporation was a "natural entity" with pre-political rights analogous with those of individuals.[34] Treating the corporation as a

[33] See Horwitz, *Transformation of American Law*, 71 90-98; David Millon, "Theories of the Corporation," 211-16; Otto Gierke, *Political Theories of the Middle Age* (Translated by Frederic Maitland), (Boston: Beacon Press, 1958); Frederic Maitland, "Moral Personality and Legal Personality" in H. A. L. Fisher, ed., *The Collected Papers of Frederic William Maitland*, vol 3 (New York: Cambridge University Press, 1911), p 304; Ernst Freund, *The Legal Nature of Corporations* (Chicago: University of Chicago Press, 1897).

[34] The group rights of German Idealism was not consonant with the methodological individualism of natural rights theories in America. Its adaptation in the United States required stripping the group natural rights element foundation from this theory. Horwitz, *Transformation of American Law*, 70-

natural entity dispensed with the problems associated with the partnership theory.

The Private/Public Distinction

Lockian individualism seeks to make a sharp private/public distinction, and to limit legitimate government actions to only the latter. The development of a market economy in the nineteenth century sharpened this distinction.[35] However, corporation law in both statute and in case law challenged the traditional notions of the distinction between public and private spheres. As Horwitz notes, the *Dartmouth College* case emphasized this distinction, making the corporation a private concern rather than an extension of the state.[36]

The effort to make a bright line public/private distinction was challenged by the practice of corporation charters. Early corporate charters were granted to private corporations in order to improvements for the public good. Thus corporations were chartered to build and operate bridges, roads, canals, public utilities, and banks. As the century progressed, states began enacting charters for business purposes that did not have so obvious a public function. States chartered municipal corporations that had private attributes, including the ability to hold property and make contracts. States also chartered private corporations that were granted rights to eminent domain, and provided public service. These "hard cases" posed a challenge to a sharp

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[35] See Karl Polanyi, *The Great Transformation* (Boston: Beacon Press, 1957). Morton J. Horwitz, "The History of the Public/Private Distinction," *University of Pennsylvania Law Review*, v. 130 (1982), 1423-28, 1424.

[36] Horwitz, "The History of the Public/Private Distinction,"1425. *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat) 518, 559, 669-73 (1819).

public/private distinction. Most famously, *Munn v. Illinois* (1877)[37] sought to make a distinction between corporations "affected with the public interest" that could be regulated by the state. Oren Bracha argues that the creation of the category of quasi-public corporation was actually evidence of an effort to clarify the split between the private and public realms. Thus, he argues that in the late nineteenth century public corporations were considered to potentially have both public and private capacities, and private corporations potentially had both quasi-public and fully private capacities. The intermediate categories enabled bright line distinctions between public and private to persist.[38] The mode of classical legal thought that dominated judicial rulings during the Lochner era from 1905 to 1937 was predicated on a sharp distinction between the public and private spheres. The legal realist critique was in part an effort to expose this distinction as artificial.[39]

The principal agent problem posed a dilemma for corporate capitalism. Orthodox concepts of principle and agent that were adequate for small partnerships, and even small proprietary corporations, were inadequate for the large modern corporation. With the transformation to corporate capitalism came the need to redefine the legal status of directors as trustees rather than as agents. According to Horwitz, the law was forced to change to accommodate a developing national market characterized by impersonal relations. The way out of the dilemma was to change the law, and legal doctrine.

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37 94 U.S. 113.

38 Oren Bracha, "Corporate Theory, Tilt and Legitimation: The Historical Narrative Reexamined," (Unpublished manuscript, 7/1/03 draft), 39-52.. Citation with permission of the author.

39 Horwitz, "The History of the Public/Private Distinction," 1426.

The Disconnect of Corporate Privileges and Immunities

The transformation of the legal theory of the corporation required a significant adjustment in the judicial construction of the legal status of corporations. At issue is whether the corporation is a "person" under specific clauses of the United States Constitution. There is a notable disconnect between its exclusion under Article IV and its later inclusion under the Fourteenth Amendment.

In *Paul v. Virginia* (1869)[40] the U. S. Supreme Court was presented with the question of whether a corporation was covered as a person under the meaning of Article IV of the United States Constitution. Article IV states that "The citizens of each state shall be entitled to the privileges and immunities of citizens in the several states." The issue in that case was whether Virginia could enact licenses and required bonds to be posted by foreign insurance companies but not on insurance companies chartered in the state. Justice Field ruled that the Article IV privileges and immunities clause did not apply to corporations. His reasoning that the privileges and immunities clause was intended to give citizens rights in the various states under the laws of each state. A privilege given by a state to citizens in that state was not intended to give those same citizens those same privileges in another state. It was not intended to give one state the right to legislate operations in another state. He noted that most business is conducted by corporations. If the court were to allow corporations privileges and immunities of citizens, then "it is easy to see that, with the advantages thus possessed, the most important business of those States would soon pass into their hands. The

[40] 75 U. S. 168.

principal business of every State would, in fact, be controlled by corporation created by other States."[41] Field restricted this counterfactual, oddly enough, to circumstances where all the shareholders of a corporation were from one state, doing business in another state.

The reasoning in *Paul* was predicated in part on the reasoning by Chief Justice Taney in *Bank of Augusta v. Early*.[42] There, the Court ruled that corporation contracts executed in one state would have validity in another state, absent an overt restriction in the second state's statutes. Validity of contracts was the default rule. The second state retained the right to make what restrictions it deemed appropriate. In using the privileges and immunities clause of the Article IV to determine the true legal nature of a corporation, Taney reasoned that if a citizen in Georgia were a shareholder in a corporation, and the citizen had the benefits of a corporation able to operate in Alabama, this citizen would have greater rights in Alabama than a citizen of Alabama. This, he thought, could not have been contemplated or been expected by the founders of the Constitution.[43] Thus a corporation was an artificial entity that was not merely reducible to its shareholders.

The Fourteenth Amendment to the Constitution of the United States passed in 1868.[44] Section One included three clauses protecting the rights of individuals:

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41 *Paul v. Virginia*, 75 U. S. 168, at 182.
42 *Bank of Augusta v. Earle,* 38 U.S. 519.
43 Ibid., 6 .
44 Precisely what might be meant by the term "Privileges and Immunities" means, irrespective of corporation law, is not absolutely clear. For a discussion of Congressional debates over meaning of the term as applicable to the Civil Rights Act of 1866 and the construction of the Fourteenth Amendment, see Brest, Levinson, Balkin and Amar, *Processes of Constitutional Decisionmaking: Cases and Materials, 4th ed.* (New York: Aspen Law & Business, 2000), p242-249.

privileges or immunities, due process, and equal protection. In short order the first of these was virtually read out of the Constitution by Justice Miller, writing the lead opinion in *The Slaughterhouse Cases* (1873).[45] The privileges or immunities clause states that "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States." Parsing the text carefully, Miller noted that the United States was characterized by dual sovereignty, and that people potentially had citizenship both in the United States as a whole, and in the state wherein they reside. He interpreted this clause to prohibit States from abridging privileges and immunities of persons only in their capacity as "citizens of the United States." It did not apply to prohibitions of states abridging privileges or immunities of citizens of their own state. In this interpretation, that was a matter of the state's own business. Miller also ruled that the equal protection clause only applied to the newly free African-Americans and not to corporations.[46]

In dissent, Justice Field referred to the Article IV provision of the Constitution to derive a proper construction of the Privileges or Immunities clause of the 14th Amendment.[47] He noted the prior history of the clause, relying on *Corfield v. Coryell* (1823).[48] Field's summary of the interpretation of this Article IV is that "No discrimination can be made by one State against the citizens of other States in their enjoyment, nor can any greater imposition be levied than such as is laid upon its own

45 *The Slaughterhouse Cases,* 83 U.S. 36 (1873).
46 Ibid., 81.
47 It is worth noting, for hyper-textualists, that Article IV refers to "Privileges *and* Immunities" while the 14th Amendment refers to "Privileges *or* Immunities" (emphasis mine). However, Justice Field, in using Article IV as a means of interpreting the 14th Amendment, treats the clauses as identical.
48 4 Washington's Circuit Court, 371; 6 F. Cas. 546.

citizens. It is a clause which insures equality in the enjoyment of these rights between citizens of the several States whilst in the same State."[49] He also referred to his own opinion in *Paul v. Virginia*, and did not find it to be an impediment to his interpretation in the case: "The whole purport of the decision was, that citizens of one State do not carry with them into other States any special privileges or immunities, conferred by the laws of their own States, of a corporate or other character. That decision has no pertinency to the questions involved in this case. The common privileges and immunities which of right belong to all citizens, stand on a very different footing."[50] In other words, Field notes in *Paul v. Virginia* that a corporation is not a person under the meaning of Article IV. Further, if a corporation is not a person under the meaning of Article IV privileges and immunities, it is also not a person under the meaning of the 14th Amendment privileges or immunities clause.

In this context the well known case of *Santa Clara County v. Southern Pacific Railroad* is most striking in its disconnect from prior doctrine.[51] The *Santa Clara* case declared that corporations would be treated as persons under the equal protection clause of the 14th Amendment of the United States Constitution. This ruling was remarkably brief, and declared without lawyer's briefs. Chief Justice Waite stated that

> The court does not wish to hear argument on the question whether the provision in the Fourteenth Amendment to the Constitution, which forbids a State to deny to any person within its jurisdiction the equal protection of the laws, applies to these corporations. We are all of opinion that it does.[52]

49 *The Slaughterhouse Cases*, 83 U. S. 36 (1873) at 98.
50 Ibid., at 100.
51 *Santa Clara County v. Southern Pacific Railroad Company* (1886) 118 U.S. 394.
52 Ibid.

Here the court famously gave no grounds for its dicta that the equal protection clause was applicable to corporations. It is notable that in this dicta there is no mention of the other clauses of the first section of the 14th Amendment, namely the due process clause and the privileges or immunities clause. In *Paul v. Virginia* Field addresses the meanings of Privileges and Immunities. Yet here the court did not discuss whether one of the clauses ought to apply to corporations but the others ought not. Remarkably, there has been little if any discussion of this in the literature.

It is logical to suppose that the meaning of Privileges and Immunities in Article IV ought to be identical to the meaning of Privileges or Immunities in the Fourteenth Amendment. It is also logical to suppose that the three clauses of the Fourteenth Amendment (Privileges or Immunities, Due Process, and Equal Protection) ought to be treated similarly as to their application to corporations; either they should all apply, or note of them should apply. It is interesting in this context to remember that in *Slaughterhouse* the Privileges or Immunities clause was for all intents and purposes read right out of the Constitution, and the Due Process clause was interpreted extremely narrowly. Yet that is no reason not to apply the three clauses to corporations in a similar manner. With the Privileges or Immunities clause of the 14th Amendment already having been read out of the Constitution, the application of the Equal Protection clause to corporations was feasible, by merely eliding the prior history of Article IV.

If this is correct is leads to a peculiar observation. Justice Field dissented in *Slaughterhouse*, arguing that the Fourteenth Amendment ought to be read broadly.

Yet the *Slaughterhouse* decision, by eviscerating the Privileges or Immunities clause, made it easier to ignore the interpretation of Article IV in P*aul v. Virginia*, and to apply the Equal Protection clause to corporations in *Santa Clara*. We might then surmise that the *Slaughterhouse* decision was in the long run beneficial to Field's effort to include corporations under Fourteenth Amendment protections. Counsel in *Santa Clara* could not make a Privileges and Immunities argument. The court instead made an Equal Protection ruling via dicta that might have seemed at odds with the *Paul v. Virginia* precedent. By making the ruling via dicta, the court was more easily able to avoid mention of this anomaly.

It is notable that at least some contemporaries did make the connection. [53] Delegates at the Kentucky Constitutional Convention of 1890 cited the *Paul v. Virginia* line of precedents that the corporation was not protected by the Privileges and Immunities clause of Article IV. After quoting extensively from *Paul v. Virginia* one delegate noted:

> "This is sufficient to show that foreign corporation can find no crumb of comfort in article four of the Federal Constitution. Now, when I am asked concerning their rights under the fourteenth amendment, I do not hesitate to say that, in my judgment, their status is not very much improved with respect to the matter under consideration. I do not think they are "persons" within the language of that amendment, unless within the jurisdiction of our State. The language is, "no State shall deny to any person *within its jurisdiction* the equal protection of the laws."
>
> But the trouble is that they cannot come within our jurisdiction unless we consent to it. But, as we have seen, we have the right to withhold this

[53] In addition, delegates at the Ohio Constitutional Convention of 1874 also made (inexact) reference to the decisions of Paul v. Virginia (that a corporation is a person for purposes of jurisdiction, but not for purposes of Article 4.) Ohio, Constitutional Convention (1873-4), *Official Report of the Proceedings and Debates of the Third Constitutional Convention of Ohio; Assembled in .... Cincinnati.... December 2, 1873, 4 vols.*(Cleveland: W. S. Robinson, Printers to the Convention, 1873-4), 2481-2, 2484.

> consent, almost without limit. And until we have allowed them to come within our jurisdiction, they cannot, by possibility, be *persons* within the Fourteenth Amendment....
>
> The result is, that we have the right to say that foreign corporations shall not be "persons," within the fourteenth amendment, so far as we are concerned; and if we do, the word person becomes limited, as to us, to natural persons, so far as non-residents are concerned.[54]

In the discussion there is no mention of the *Santa Clara* decision, suggesting that otherwise knowledgeable lawyers were not aware of the dicta. In any case it demonstrates that contemporaries connected Article IV to the Fourteenth Amendment, and thought it reasonable to apply the two sections of the Constitution to corporations in a like manner.

In light of this, it is all the more striking in discussions of corporate personality that no commentator I have come across connects the line of precedents through *Paul v. Virginia* to the line of precedents that begin with the dicta of *Santa Clara*.[55] Horwitz's discussion of *Santa Clara* centers on the contention that the natural entity theory was not developed in the United States until the 1890's.[56] Others have accepted Horwitz on this point, at least, even if they disagree on whether the impact of the natural entity theory in the 19th century as a legitimator of corporate capitalism.[57]

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[54] Kentucky, Constitutional Convention (1890), *Official report of the proceedings and debates in the Convention assembled at Frankfort, on the eighth day of September, 1890, to adapt, amend, or change the constitution of the state of Kentucky, 4 vols.* (Frankfort, Kentucky: E. P. Johnson, printer to the Convention, 1890 [1891]). Vol. 3, 3673. Emphasis in original.

[55] In a footnote, Bratton notes that the corporation does not have Article IV rights, but does have Fourteenth Amendment rights. However, he does not allude to any logical difficulty in such. He regards this as perfectly within the tradition in law of nineteenth century legal treatises, and suggests that this tradition is parallel, but separate from other elements in legal discourse. William J. Bratton, The New Economic Theory of the Firm: Critical Perspectives from History," *Stanford Law Review*, vol. 41 (July, 1989), 1471-1525, n. 157 at 1503.

[56] His concern was to show that the Court could not have had the natural entity theory in mind when *Santa Clara* was decided in 1886. Rather, he argues, this decision was predicated on language indicative of the partnership theory. In that circumstance, individuals had equal protection rights as a result of membership in a corporation. Horwitz, *Transformation of American Law*, 69-74.

[57] See for example, Millon, "Theories of the Corporation."

The Corporation as a Political Construction

An important element regarding the nature of the firm reduces to the nature of the grant. That question is: does it make a difference in corporate theory whether a corporation was created by special legislative enactment or by a general law? Under the grant theory, a corporation charter is a grant from the sovereign. These were made be special legislative enactments. With the advent of general laws, corporations were created at the initiative of a group of individuals, meeting a predefined set of procedures. Horwitz asserts that general laws placed stress on the artificial entity theory. Because charters were available to all applicants they were no longer a "grant."[58] There are two ways of addressing this issue: first, by an examination of legislative intent, and second by logic.

As the next chapter will show, there is no such concern by delegates to constitutional conventions who argued in favor of general laws; their concerns were two-fold: first, that the granting of special favors that favored some interests at the expense of others, and second, that the creation of special legislation was swamping the legislature. To create corporations by general law would save the legislature time.

The question then is whether making charters ubiquitous alters their nature as a "grant" from the sovereign. The legislatures clearly thought not. There were issues about how to treat corporations created before the general laws, as opposed to those created after the general laws. What they sought to achieve was uniformity in the laws of corporations, which would create a level playing field; this, one might suspect, is a

[58] See note 34, above.

goal that would be supported by legal academics and neoclassical economists.

In most cases the law did not treat a corporation created by general laws differently than a corporation created by special legislation. The transition form special privileges to uniform general laws did require a some selective treatment of the old firms. The firms enacted by special law sometimes had vested rights. To eliminate these over time states enacted provisions requiring that if a corporation desired to take actions not previously allowed to it, that corporation must accept the requirements of the state constitution. This brought the existing corporation in line with the general laws, the same as the corporations enacted under general laws. Because corporate purposes were typically written narrowly, corporations wishing to expand operations would have to accede to this state demand.[59] Some states did seek to regulate specially created corporations differently. In Michigan, for example, the state constitution did allow the legislature to grant special corporations with a two-thirds vote, and also allowed the legislature to amend that same charter with a majority vote. Corporations made by general law could follow the procedures laid out in law.[60] However, in other regards, there is no difference. Laws of contracts, of tort, of agency would apply equally to corporations created by special law or by general law. This indicates that the mere creation of a corporation by general laws available to all does

[59] For example, the Kentucky provision stated: "No corporation in existence at the time of the adoption of this Constitution shall have the benefit of future legislation without first filing in the office of the Secretary of State an acceptance of the provisions of this Constitution." Kentucky Constitution of 1890, Sec. 190.

[60] Michigan, Constitutional Convention (1867), *The Debates and Proceedings of the Constitutional Convention of the State of Michigan, Convened at the City of Lansing, Wednesday, May 15, 1867*, Official Report by Wm. Blair Lord and David Wolfe Brown, 2 vols. (Lansing, MI: John A. Kerr & Co., printers to the state, 1867.)

not eliminate the fact that the corporation is a grant. But it is a particular type of grant, that must be made available indiscriminately.

State legislators had to contend with the pressures that led to a crisis of legal orthodoxy. However, legislatures have a different mix of pressures than do courts. State legislature, in particular, are the branch of government intended in theory to be least insulated from public pressure. Thus legislators had to meet the challenges to orthodox conceptions of the law while mediating pressures to maintain economic growth and accommodate new corporate demands without losing state authority.

This research strongly supports the analysis of Charles McCurdy in regards to the *E.C. Knight* decision of 1895. In that case the Supreme Court made a distinction between indirect effects of commerce and direct effects. They ruled that manufacturing was distinct from commerce, and that manufacturing had only an indirect effect on commerce. Therefore they narrowly construed the power of Congress to regulate economic activity, and narrowly construed its power under the Sherman Antitrust Act of 1890. McCurdy argues that at that time it was still reasonable to expect that states would be able to regulate corporations via statutory law. To allow the federal government latitude in this area would weaken the states' ability to do so.[61]

That the legislatures thought they had the ability to shape the constitutive rights of corporations is evident from the variety of restrictions that were placed in their corporation law. There were two major types of concerns. First, that individuals

[61] Charles W. McCurdy, "The Knight Sugar Decision of 1895 and the Modernization of American Corporation Law, 1869-1903", *Business History Review*, 53:3 (1979), 304-342.

not be unfairly disadvantaged relative to corporations, and second, to advance the industry in the state.

Commentators have noted that most discussions of corporate attributes remain separate from close analysis of corporate theory.[62] Certainly not all legislators needed to be deeply steeped in corporate theory to propose and implement either special legislation or modifications to general incorporation laws. This is supported by the record of state constitutional conventions. We see confusion among delegates at times over what the corporation was, with some delegates propounding a partnership theory, and others an entity theory, without necessarily recognizing the inherent contractions.[63]

There is no question, however, that some contemporaries were well versed in the law. Further, and none had any doubt over the right of the state to regulating and in some ways control the corporate entity. The debates were over the policy of greatest wisdom, which policies would give the economy the greatest chance for advance, and also questions of equity. State corporation law has a role in regulating the economy by shaping corporation law.

How the corporation became large bears on how the state should treat the corporate entity. At issue in the nature of the corporation is role of the state in regulating relations between shareholders, management, workers, creditors, and customers. As William Bratton notes, the state reserves the right to alter the terms of

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62 See Bratton, "New Economic Theories of the Firm," 1471.

63 This is precisely as characterized by the philosopher John Dewey in a famous 1926 article on the indeterminacy of corporate theory. John Dewey, "The Historic Background of Corporate Legal Personality," *Yale Law Journal*, v. 34 (April, 1926), 655-73.

corporate creation.[64] But the point deserves greater emphasis than Bratton gives it, because it directs our attention to political influences on corporate creation. One obvious point is that the statutory history of corporation law developed in Chapter Three points to choices that were taken at one point in time, but are no longer implemented. Greater state regulation of corporate charters is certainly well within the *laissez faire* tradition of American politics.

This observation leads us to a more substantial conclusion as we seek to appreciate the place of the American corporation in a developmental perspective. The liberalization of corporate charter law so that the corporation could do anything it wanted grew not merely out of a single state responding to a robber baron's request. It grew through a century of state experimentation with legal forms. These legal forms sought to keep state restraints over the corporation while at the same time unleashing entrepreneurial energies. The legal code was used as a vehicle for promoting economic growth. The variety of economic profiles and economic interests provided grist for legislative innovation. States created the situations in which corporations operated. The context of private and public operations gave rise to the constitutional law conundrums that confronted the Supreme Court in its great antitrust decisions, particularly *Trans-Missouri* (1897), and the *Standard Oil* case (1911).[65]

Many elements of corporation law adjudicated in the courts used to be done via statute. For example, David Millon traces doctrinal changes in internal corporate governance, regulated by court decisions. In the late 19th century a majority could bind

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[64] Bratton, "The Nexus of Contracts" Corporation," 445.
[65] See Sklar, *Corporate Reconstruction.*

the minority only in particular circumstances, namely on the sale of assets due to a bankruptcy; however, a series of rulings in the early 20th century allowed a bare majority to bind the minority.[66] In the nineteenth century, much of this was regulated by state statute. States often clearly indicated what percentage of shareholders was necessary to effect the increase in capital stock, the purchase of another firm, or other types of significant market transactions. States could still impose restrictions, and define rights and duties. It is a power gone dormant due first, to the dynamics of federalism, and second to impassivity born of a forgotten legacy It is only in the absence of such state action hat the courts get involved in defining fundamental rights.

The creation of corporation laws has been shaped by federalism. The application of a continuous application of knowledge to elements of production has been accompanied by legislative enactment to protect economic interests and release entrepreneurial energies. In the United States corporations are chartered in the states. Revenue for the right to charter goes to the state that granted the charter. Yet the corporation extends across political boundaries, and finds itself under the protection not only of laws of other states (due to comity between the states), but also under the protection of the United States government[67] This allows states (now Delaware in particular) to exact conditions on political entities outside of its political boundaries. Debates in the legal profession have been over whether the federal system of charter

[66] *Geddes v. Anaconda Copper Mining Co*. (254 U.S. 590, 596 (1921); *Metcalf v. American School Furniture Co.*, 122 F. 115, 119 (W.D. N.Y. 1903); *Butler v. New Keystone Copper Co.*, 10 Del Ch. 371, 378, 93 A. 380, 383 (1915). He also notes that state legislatures by the early 1920's had allowed mere majority approval to make fundamental changes. Millon, “Theories of the Corporation,” 215.

[67] For example, the *Santa Clara* case granting corporations 14th Amendment equal protection status.

specialization has resulted in a “race to the bottom” which has resulted in the lowering of social standards, or a “race to the top” that has promoted economic efficiency.[68] Either way, the construction of corporation law has been intricately shaped by the dynamics of American federalism.

The Corporate Tradition in American Politics

Legal discourse in the nineteenth and early twentieth century included debate over the legal personality of corporations. At issue was whether the corporation was a "person" in the meaning of the law, whether it was an "real" entity, whether it was a "natural entity," or whether it reduced to its shareholders. The corporation does not necessarily fit any such category. It is an archetype of its own. John Dewey argued in a famous article that the corporation is just what the law says it is. To put it another way, the corporation is.....a corporation.   In contemporary terms, it is a legal construct. What I then argue here is that the statutory history should properly inform our conception of the corporation. Its construction was not merely in courts of law or in arguments in legal treatises, but it was also constructed in state statutes in particular settings.

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[68] William Cary initiated debate by arguing that state competition led states to favor management at the expense of shareholders because it is the managers who are in a position to shop among states for the most favorable charter. William Cary, “Federalism and Corporate Law: Reflections Upon Delaware,” *Yale Law Journal,* (1974) 83: 663-705. Daniel Fischel argued that the resulting economic efficiencies led to a “race to the top”, while Lucien Bebchuk and Allen Ferrell argue that economic inefficiencies have been the result. Daniel R. Fischel, “The ‘Race to the Bottom’ Revisited: Reflections on Recent Developments in Delaware’s Corporation Law”, *Northwestern University Law Review*, (1982) 76: 913-45. Lucien Arye Bebchuk and Allen Ferrell, “Federalism and Takeover Law: The Race to Protect Managers from Takeovers,” *Columbia Law Review* (1999) 1165, 1168.

To point to state capacity, and in particular, legislative capacity, is to pay more attention to politics. In this, there is a directional trajectory to corporation law. Andrew Gamble has noted that power politics are predicated on domination of the "ruling mode of production." He states, "A mode of production cannot be legislated away by the government. It is the objective structure on which the state rests, and which the state exists to uphold."[69] The political system operates as a ratchet. Once a corporate privilege is won, it is taken back only with great difficulty. Such circumstances may occur in economic depression, or corporate scandal. That the state does not legislate away corporation rights is a question of politics. Some of the most powerful politics are those that are not questioned. Such is the case of the corporation. Yet it is the federal system, with competition between the states that fixed the attendant rights and duties of the corporation, in which decisions regarding the shape of the corporation is made.

Legal change has at least adapted to, and possibly promoted the development of the dominant mode of production, including accommodating the concentration of power in a few hands. It has interacted with entrepreneurial influences to restructure and complicate relations to the means of production. In order to position themselves to leverage power, one need not be an owner. Rising to upper echelons of management places an individual in the position in the position of making claims on corporate wealth.

The construction of the business corporation has had a profound impact on

[69] Andrew Gamble, *The Conservative Nation* (London: Routledge & Kegan Paul, 1974).

American politics. This impact pervaded the political economy, and thus impacted the nature of American ideology. Louis Hartz argued that America is liberal because it has always been liberal, due to irrational mass Lockianism.[70] Rogers Smith has countered that this depiction misses much of the American tradition.[71] He recounts illiberal traditions in the treatment of racial, ethnic, and religious minorities. Karen Orren has argued that these other traditions can be better characterized and theorized as multiple subordinations.[72] She also argues that there is are significant vestiges of a feudal component that the development of labor relations in American politics.[73] Thus there is a rich debate over characterizations of America's ideological traditions.

America also has a corporate tradition. It is a tradition that dates to even before the founding of the republic. It found life in Alexander Hamilton's successful effort to charter the First Bank of the United States. It found life in the many states' uses of the charter to put into effect public improvements. It changed over the course of the 19th century, both responding to and giving animation to new forms of economic organization. This corporate tradition developed not only in antitrust, as so well depicted by Martin Sklar.[74] It existed in those elected bodies that are closest to the people, state legislative bodies. State legislatures altered the terms of corporate

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70 Louis Hartz, *The Liberal Tradition in America: an Interpretation of American Political Thought Since the Revolution* (New York: Harcourt, Brace, 1955).

71 Rogers Smith, *Civic Ideals: Conflicting View of Citizenship in U.S. History* (New Haven: Yale University Press, 1997).

72 Karen Orren, "Structure, Sequence, and Subordination in American Political Culture: What's Traditions Got to Do with It?" *Journal of Policy History,* vol. 8, no. 4 (1996), 470.

73 Karen Orren, *Belated Feudalism: Labor, the Law, and Liberal Development in the United States* (New York: Cambridge University Press, 1991).

74 Martin J. Sklar, *The Corporate Reconstruction of American Capitalism, 1890-1916* (New York: Cambridge, 1988).

existence, while the judiciary theorized and adjudicated its characteristics from within the common law tradition, and the statutory standards promulgated by the legislatures.

It is a tradition that exists alongside, and intermixed with, the liberal tradition of American politics. This coexistence has at times been uneasy, because the American corporate tradition does not reduce to Lockian individualism. Nor is it pre-political. Rather, corporate rights were granted from the political system. The corporate practice can be traced to Tocqueville's observation about Americans tendency to associate, and also his observation that lawyers formed the aristocracy of the American republic.[75] Corporation law formalized the organization of group association. It germinated in those elected legislative bodies that are closest to the people, in the states.

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75 Alexis de Tocqueville, *Democracy in America* (George Lawrence, trans.), (New York: HarperPerennial, 1988), 188-195.

Chapter 5

Corporation Law in the State Constitutions

It is clear from the preceding chapters that states actively regulated the parameters of corporate existence. Nevertheless, it is difficult to find detailed arguments about what legislators thought about the enterprise of forming corporation law. Most states did not record the debates of ordinary legislative sessions, leaving us with a paucity of records indicating actual thought regarding corporate entities. We know the exact language of what the state legislatures promulgated, but not the reasoning or compromises that they made. Fortunately, there is another source. Most states placed provisions on corporations in their constitutions. Further, through the course of the late nineteenth century many states held constitutional conventions, and typically stenographically recorded the debates and proceedings. These records provide illumination of the legislative mindset.

The record leads to several observations. First, there was deep state involvement in regulating the role of corporations. Delegates sought to promote their local political economies, yet at the same time protect individual citizens. The primary tool was statutory law, within the parameters set by state constitutional law. Second, the delegates at the conventions justified their regulatory actions with the artificial entity theory. This justification was used both as the basis enactment of restrictive regulations, and also as a means to justify liberal corporate provisions. Thus the artificial entity theory was used to justify the statutory foundations of corporate capitalism. Third, there is evidence of the impracticality of orthodox conceptions of the law among the delegates, as well as a recognition that the new problems being confronted could not be solved with old solutions. Fourth, there is evidence of a transformation in conceptions of the proper role of the state in regulating actions of corporations within their political economy. There is, in general, greater acceptance of liberal provisions at the end of the century. This liberalization includes not merely limited liability, but also universal general corporations laws that authorize broad purposes, fewer restrictions on term of existence and real estate, and a reduced role of the state in regulating specifying legitimate corporate purposes. This amounts to an evolution in mentalities regarding the relationship of the corporation to the state. Fifth, there is evidence of an increasing lack of ability of the states to regulate their economies through statutory corporation law. States became increasingly aware of the impact of foreign corporations (those chartered in other states, or abroad) on their soil. Foreign corporations present some difficulties right after the Civil War. However, with completion of the transportation network, and the building of a national market, the impact of foreign corporations increased. At the same time, the capacity of the states to control the effects of foreign corporations lessened dramatically.

Charles McCurdy argues that up to the end of the nineteenth century it was imaginable that the states could control the corporation. Thus he argues that the *E.C. Knight* case must be understood as an attempt to preserve these state capacities.[1] The findings of this chapter largely support McCurdy's thesis. Most actors had at least

1 Charles McCurdy, "The *Knight* Sugar Decision of 1895 and the Modernization of American Corporation Law, 1869-1903." *Business History Review,* 53:3 (1979).

some notion of a role for the state in regulating their creation. However, state capacity was also clearly in decline. Further, a national market could not be built unless state powers to restrict corporate behaviors declined. The Supreme Court acted at key junctures to prevent the states from restricting foreign corporations.

The decline in state capacities resulted from the dynamics of federalism interacting with a rapidly industrializing economy transformed by the completion of a national transportation network. This state incapacity at the turn of the century paved the way for the statebuilding and expansion of national administrative capacities that would soon follow.[2]

Records of the State Constitutional Conventions

There are both advantages and disadvantages to using the records of the state conventions. First, there is a limitation to the types of provisions that were discussed, debated, and enacted. As a general rule, only the most fundamental provisions were written into the state constitutions, leaving other issues to be promulgated by state legislatures. However, the setting of the convention provided a forum for a relatively highminded debate on principles of political economy, and the role of the states in providing rules to regulate the corporation. Delegates were cognizant that they were adjusting the organic law, and that what they put in place might well last for a generation or longer. This led to at least the attempt to couch provisions in terms of

[2] For a narrative on building state administrative capacity, See Stephen Skowronek, *Building a New American State: The Expansion of National Administrative Capacities, 1877-1920* (New York: Cambridge University Press, 1982.)

fundamental principles. It is an advantage for us that delegates discussed principles of economic policy in the most general of terms.

Second, delegates recognized that the fundamental principles established in the state constitution would guide the parameters of subsequent legislation. Thus delegates discussed how specific provisions might impact industries or individual companies. The problem of predicting future courses of action was more pronounced for convention delegates that it would be for legislators. Constitutions conventions are held less frequently than legislative sessions, and constitutions are more difficult to amend than ordinary legislation. Thus delegates recognized that mistakes or omissions would be difficult to correct, and this led some to be wary of constitutionalizing some provisions, while it motivated others to more adamantly insist on establishing favored provision in the organic law.

Third, the records are not necessarily representative across space and time. Constitutional conventions were called on episodically, not regularly. Further, constitutional conventions were not called solely or primarily to adjust incorporation law (although it was one of four major issued confronted in the California Constitutional Convention of 1878.)   Thus although several constitutional convention dealt with corporation law, not all of them did. In particular, reconstruction and post-reconstruction conventions in the South had other pressing issues at stake. In addition, not every constitutional convention recorded the debates and proceedings. Because they are not representative, a true random sample is not possible. Table 5.1 shows which states held conventions during the period of this study, which of these recorded

Table 5.1 Constitutional Conventions, 1865-1900

Year	State	Debates Recorded	Corporations an Issue
1865	Alabama	No	
	Florida	No	
	Georgia	No	
	Mississippi	Yes	n.a.
	Missouri	No	
1865-6	North Carolina	No	
1866	Texas	No	
1867	Alabama	No	
	Maryland	Yes	No
	Michigan (rejected)	Yes	Yes
1867-8	Georgia	No	
	Louisiana	No	
	Mississippi	No	
	New York	Yes	No
	North Carolina	No	
	Virginia	Yes	n.a.
1868	Arkansas	Yes	No
	Florida	No	
	South Carolina	Yes	No[1]
1868-9	Texas	No	
1869-70	Illinois	Yes	Yes
1870	Tennessee	Yes	No
	Vermont	No	
1879	Louisiana	No	
1871	Nebraska	Yes	No[2]
1872	Pennsylvania	Yes	Yes
	West Virginia	No	
1873-4	Ohio	Yes	Yes
1874	Arkansas	No	

1875	Alabama	No	
	Colorado	Yes	n.a.
	Missouri	Yes	Yes (n.a.)
	North Carolina	No	
	Texas	No	
1876	New Hampshire	No	
1877	Georgia	Yes	No
1878	California	Yes	Yes
1885	Florida	No	
1889	New Hampshire	No	
1890	Kentucky	Yes	Yes
	Mississippi	No	
1894	New York	Yes	No
1896-7	Delaware	Yes	Yes
1898	Louisiana	No	

Entries are made on the issue of corporations only if the debates were recorded.

States with no convention 1865-1900:
Connecticut
Iowa
Kansas
Maine
Massachusetts
New Jersey
Oregon
Rhode Island
Wisconsin

States with recorded debates on corporations that are not part of this study include Illinois 1869, and Missouri, 1875.

Source: Cynthia E. Browne, *State Constitutional Conventions: From Independence to the Completion of the Present Union, 1776-1859* (Westport, CT: Greenwood Press, 1973)

[1] South Carolina had a short section on corporations that was passed with virtually no debate (p. 754-6).
[2] Nebraska in 1871 debated provisions on banks and on subsidies to railroads, but no on corporation law in general.

their debates, and which of those that recorded their debates and proceedings dealt in any significant way with corporation issues.

The analysis that follows is drawn from constitutional conventions in Michigan in 1867, Pennsylvania in 1872, Ohio in 1874, California in 1878, Kentucky in 1890, and Delaware in 1897. Michigan in 1867 was on the edge of the periphery, was dependent on mining and lumber, and in need of development. Pennsylvania was the most industrialized state in the Nation. Ohio at the time was on the edge of the metropole, but in the direct line of traffic from Chicago to New York. California was a western state, inflamed by the populism and nativism of the late 1870's. Kentucky in 1890 was struggling still to overcome the lack of development due to the vestiges of its slave economy. This made delegates there acutely aware of a need to industrialize. Delaware in 1897 was a sleepy state on the periphery of the metropole; delegates there were awaking to the possibility of modernizing corporation law to attract corporate charters.

The lack of a random sample across space and time is mediated in part by the comprehensive analysis of state policies in Chapter Three. This allows us to place the following debates and proceedings in context. For example, California is clearly an outlier on the issue of limited liability. At her convention delegates instituted proportional unlimited liability for both shareholders and directors. We know that this view was not representative of the nation as a whole. Yet the arguments in radical California place the issue in its sharpest relief.

States borrowed liberally from other states in crafting their corporation law. In particular they regularly cited similar provisions in other constitutions to justify the addition of provisions that to some delegates were sources of controversy. The procurement of debates and proceedings was institutionalized. The Pennsylvania Constitutional Convention of 1872, for example, paid for copies of all other state constitutions, and provided access to copies of debates and proceedings of the same where they were available.[3] Thus it was normal to refer to debates and proceedings of other state constitutional conventions. If another state had a positive experience with a provision, delegates would refer to it to lend credence to its appropriateness for their own state. Occasionally state practices were noted derisively. A delegate in Michigan in 1867 asked of his colleagues "Do they not know that the State of New Jersey is a by-word and derision among states, simply because it is ruled year by year through its corporations?"[4] Occasionally a delegate would read entire passages from other states debates to justify an argument. This could itself cause conflict. Said one delegate in jest at the Pennsylvania Convention, having been repeatedly told what Illinois has passed three years earlier, "I think it is a great calamity to the people of Pennsylvania that the people of Illinois have a Constitution....It is still a greater calamity they have published their Debates. We should have learned wisdom from their sad experience

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3 Pennsylvania, Constitutional Convention (1872-1872), *Debates of the Convention to Amend the Constitution of Pennsylvania: Convened at Harrisburg, November 12, 1872, Adjourned November 27, to Meet at Philadelphia, January 7, 1873... , 9 vols.* (Harrisburg: B. Singerly, 1873), v. 4 585-9, 604-5. Hereafter referred to as "Pennsylvania, *Debates* (1872)."

4 Michigan, Constitutional Convention (1867), *The Debates and Proceedings of the Constitutional Convention of the State of Michigan, Convened at the City of Lansing, Wednesday, May 15, 1867*, Official Report by Wm. Blair Lord and David Wolfe Brown, 2 vols. (Lansing, MI: John A. Kerr & Co., printers to the state, 1867.), vol. 1, 199 (Conger). Hereafter referred to as "Michigan, *Debates and Proceedings* (1867)."

and should not have published ours."[5]

The delegates at the constitutional conventions addressed the inevitable problem of interpretation of their documents. This problem was more serious than mere legislation, because the constitution could be changed only rarely. This problem was highlighted at the Kentucky convention in 1890, when there was an effort to write a strong antitrust provision. Some delegates were concerned that the broad language would inevitably come to include labor organizations in its ban.[6] This led to the observation that it would take a legal code to properly deal with the subject. One delegate suggested striking the antitrust provision entirely, because it was a matter of detailed legislation.

> "You have it too comprehensive. You have covered a great many things there that ought not to be covered. All combinations are not evil. All associations are not evil. A great many of them are purely defensive. A great many of them are made necessary for defense against the aggregation of capital.....(I)t is a new question, and one of the most difficult that any legislative body has had to contend with, because the particular evil is so hidden under different combinations—it assumes so many different forms; it lurks about in so many different corners—that the legislators of the present day have been unable to reach it, almost by the most exhaustive bills on the subject, and to hope now, with four or five lines, to reach this evil, it seems to me is absurd."[7]

One Michigan delegate noted the problem of statutory construction: "I at one time labored under the idea that those who made the law might be permitted to construe them. The court very properly and very wisely informed me that judicial

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5 Pennsylvania, *Debates* (1872), vol. 4 p.593 (Cuyler).

6 Kentucky, Constitutional Convention (1890), *Official report of the proceedings and debates in the Convention assembled at Frankfort, on the eighth day of September, 1890, to adapt, amend, or change the constitution of the state of Kentucky, 4 vols.* (Frankfort, Kentucky: E. P. Johnson, printer to the Convention, 1890 [1891], 3693-4 (Harris). Hereafter referred to as "Kentucky *Official Report* (1890)".

7 Kentucky *Official Report* (1890), 3700 (Straus).

tribunals could not construe laws according to the special ideas of those who had drawn them; that they must be construed according to the meaning deducible from their language."[8]

Delegates often asserted that specific provisions ought not be in the constitution, that they had characteristics of legislation. One delegate in Ohio asserted that such an argument was sophistry. He suggested instead that whether or not a provision was appropriate material for a constitution depended on whether or not one liked the provision: "It has been said here that this is a matter of legislation.....I have not heard any definition here of constitutional law as contradistinguished from legislation. I do not know where to draw the line. Nobody has attempted to do it. It is legislation when they do not want it, and it is constitution when they want it thrust into this fundamental law."[9]

The Nature of the Corporation

The dominant conception of the corporation in the mid-19th century was that it was an artificial entity created by the state.[10] This informed legislative and convention delegate justifications for crafting provisions that would impact the shape of the corporation. The statements of the artificial entity theory were employed to characterize the corporation right up through the end of the century. Thus a delegate at

8 Michigan, *Debates and Proceedings* (1867), v. 1, 199 (Conger).

9 Ohio, Constitutional Convention (1873-4), *Official Report of the Proceedings and Debates of the Third Constitutional Convention of Ohio; Assembled in ....Cincinnati.... December 2, 1873, 4 vols.* (Cleveland: W. S. Robinson, Printers to the Convention, 1873-4), 2388 (Page). Hereafter referred to as "Ohio, *Official Report* (1873-4).

10 See Morton J. Horwitz, *The Transformation of American Law, 1870-1960: The Crisis of Legal Orthodoxy* (New York: Oxford University Press, 1992), ch. 4.

the 1897 Delaware convention noted:

> A corporation is an artificial body, created by law, having perpetual succession, or succession for such period as the act preceding and creating it shall limit; it can sue and be sued by a name which is given to it; and it has a corporate seal. Those three qualities are such as, to my mind, limit and mark them as distinctive character. What we mean by a corporation having perpetual succession is thus: As in contradistinction from every association of individuals owning property or carrying on business. If two or more persons carry on business under any name (as they have a right to do) other than their individual names, and one of them dies, that entity does not go on to exist; that interest descends, if it be real estate, to the heirs at law of the person deceased, or is distributed among the general representatives; whereas in the case of a corporation, the stockholders, their interests, are not transferred to the heirs at law or to their personal representatives, but their ownership in the concern is represented by stock and the ownership continues in the entity.[11]

This clear articulation of the artificial entity theory was typical of many such statements. Nevertheless, delegates often connected the existence of the corporation to the shareholders, and often justified corporate rights based on the fact that shareholder rights needed to be protected. Thus they reduced the corporation to its shareholders. An example is in Michigan in 1867, where already corporations dominated much of the state economy. Said one delegate:

> "Corporations as they become wealthy and powerful, become haughty and arrogant and exacting. And no class of powers ever created by the States or the nation have ever been looked upon by the people with more jealousy than the class of powers exercised by corporations."
>
> "What is an act of incorporation? It is simply the conferring upon a number of class of persons authority to do what an individual may do. And where is the necessity for a departure from the principle in relation to the rights and immunities that are extended to individuals, if it is not for some nefarious purpose of giving these corporations some advantage over the people? I take it that so far as a corporation is concerned, it should not have any more rights or privileges, when undertaking to perform a particular thing, that an individual would have if he possessed the capital and means for the

[11] Delaware, Constitutional Convention (1896-7), *Debates and Proceedings of the Constitutional Convention of the State of Delaware,* Reported by Charles G. Guyer and Edmond C. Hardes, 5 vols. (Milford, DE: Milford Chronicle Pub. (for) the Supreme Court, State of Delaware, 1958), vol. 2, 851-2 (Spruance). Hereafter referred to as "Delaware, *Debates and Proceedings* (1896-7)."

purpose...."

Now, I think the idea of conferring upon corporation any extraordinary powers different from those which individuals possess is all wrong. I believe it would be a departure from the fundamental principles of our government. It would be a departure from the principles upon which our laws should be based."[12]

The artificial nature informed opinions on the propriety of legislature regulation. A delegate in Michigan in 1867 argued that natural persons and corporations be treated equally. Some adjustment, however, had to be made to account for the special characteristics of corporations. In his view, "a corporation is a collection of natural persons, who by that connection become a legal body or persons. Instead of acting separately and individually, they act together in a corporation, which is regarded as a legal person."[13] He felt a 2/3 vote to create a special corporation would be a protection against bribery for special privileges, but that a majority vote should be all that was required in order to amend the special charter. "The cardinal principle with me is this: after a legal person has been created, that legal person must stand upon the same level with a natural person. Otherwise we create a corporate aristocracy; we bring into existence a set of legal entities who have superior powers and capacities over ourselves as natural persons."[14]

The conceptions of the corporation were not always clear and consistent. For example, a Michigan delegate stated "It may be said that these corporations are creatures of the law, that they exist by virtue of the law, and they should be so constructed and regulated as to induce capital to come into the state..." Either his view

[12] Michigan, *Debates and Proceedings* (1867), vol. 1, 204 (Divine).
[13] Ibid., 603 (Ferris).
[14] Ibid., 604.

of the nature of the corporation influenced his view of the propriety of the law, or perhaps his view of the propriety of the law influenced his view over the nature of the corporation. "Now why should we give to these capitalists these additional inducements, unless something is to be taken from the people to be given to them? They cannot demand it of us with any more reason than they can demand it at home. I can see no good reason for taking any right whatever from the people and giving to foreign capitalists."[15] Another delegate in the same debate had a different view, one that reduced the corporation to the individuals that compose it. Said he: "A corporation is nothing more or less than a collection of individuals to accomplish a certain purpose, which would be impossible for any one individual to accomplish."[16] Whether the delegates were aware of that the two views were inconsistent is not clear from the record. Delegates used these arguments to justify their positions, but did not refute views inconsistent with their own.

The artificial entity theory was used to justify state limits on corporate powers. Economic growth was a reason to charter corporations, but the the state maintained the right to place restrictions. As an Ohio delegate noted, "it is economical to allow the joining together of different individuals with portions of their fortune in one association, in one created artificial person, for the purpose of giving greater freedom and economy in the transaction of business."[17] However,

> "Over and above the general proposition that different kinds of business ought not to be transacted by the same monopolizing company, that there

[15] Ibid., 203 (Williams).
[16] Ibid., 211 (McKennan).
[17] Ohio, *Official Report* (1873-4), 2349 (Tuttle).

> ought to be a limit upon it; that the Legislature ought to keep that limit in its hands, and that when the Legislature has for a series of years frequently determined in what cases corporations may be formed, and thereby created a rule of polity, it is proper, I think, that it should be regarded as such."[18]

Delegates in Ohio used this sort of argument to justify chartering of corporations is specified areas, but not allowing a corporation to engage in just any sort of business.

The right of the state to regulate corporate existence via the charter law was held widely by delegates. The chairman of the committee on corporations in Kentucky in 1890 noted that "Throughout the whole report we have endeavored to carry out this idea, that corporations were simply artificial persons, and should always be amenable to the law, not any more severely or critically, but just the same as individuals; and whether property shall belong to corporations or individuals, should it be necessary under this right to take it away, the State shall have, and continue to have, the right to do so."[19] Those who vehemently opposed corporations (especially in California, 1878) argued that because corporations were in their nature void of the moral responsibility that restrained actions of individual entrepreneurs.

> (G)od alone could give us soul, and a spirit, and a conscience, but man has never given conscience, nor soul, nor moral honesty to a corporation yet, and never will. As the law creates it, so it has got no conscience. It has no rule of right, except that which is made by the letter of the Constitution and the statutes. The purpose then, sir is this, that we should lay down a rule here with our twenty thousand corporations, by which the people shall be protected in the future against the thieving and knavery and highway robbery that has been practice wholesale for twenty years upon the people of this State.[20]

Corporations were disconnected from the moral force of personal accountability that

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[18] Ibid., 2352.
[19] Kentucky, *Official Report* (1890), vol. 3. 3638 (Clardy).
[20] California, *Debates and Proceedings* (1878-9), 41

connects to a persons character as a private citizen. One delegate at the 1872 Pennsylvania convention stated:

> Corporations have more rights in this country than individuals have. It is useless to say men are free and equal while we are creating artificial bodies that have rights which individuals do not....
>
> Corporations have advantages by means of the association of capital, by means of their long life, by means of their lack of individual and of moral responsibility, and they stand opposed to the efforts of individual in this regard.
>
> Its moral responsibility is gone; he is not acting as an individual; he is acting simply as the agent of a machine. It is well known truth that corporations neither have souls to be damned nor a proper place to be kicked.[21]

A similar sentiment was expressed in eighteen years later in Kentucky:

> The building up of corporate wealth is the creation of a force in our midst to exercise its influence upon our business, political and social relations, without personal responsibility. The owners of these franchises hide their personalities behind a corporate name and organization, and thus shield themselves from political, legal or moral responsibility for their misdeeds; yet the power they exercise for evil is the greater on account of the want of individuality.[22]

Many delegates found it difficult to justify granting corporate rights, particularly limited liability, when individuals or partnerships did not have the same privileges.

> [I]n the management of all the ordinary lawful business of the country, this creature would be superior to the creator! We should set an institution above ourselves having greater privileges and advantages than would come to a private citizen in his individual pursuits after life and comfort.[23]

The counter argument focused on the property rights of the individuals that owned corporate shares:

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21 Pennsylvania, *Debates* (1872), vol 7, 765 (Dodd)
22 Kentucky (1890), *Official Report,* 3646-7.
23 Pennsylvania, *Debates* (1872), vol. 7, 769.

> I believe that capital and property should be secured; that it should be secured in the hands of a corporation as well as of an individual, because a corporation is composed simply of individuals; and when you are protecting corporate enterprises against unjust and improper attacks, you are simply protecting individual wealth against unjust, anarchical and communistic attacks...[24]

This delegate reduced the corporation to its shareholders.

The Public/Private Distinction

Early in the nineteenth century corporations were chartered exclusively for purposes that would further the public good. Thus charters for schools, charities, and public works were justified, but charters for mere pecuniary profit were not. This changed as the century progressed; states, slowly at first, but then more regularly, granted charters purely for profit making. It took time for legislators to adjust and accept this change in mindset. Said a Pennsylvania delegate in 1872:

> You remember well, sir, and so do I, the time when the only plea for corporate powers was the necessity to accomplish great ends which could not be met by individual enterprise, such corporation as were largely public in their character, public roads and great works where it was impossible to raise the necessary amount of capital by mere individual means. Now we propose to go entirely to the other extreme, and make corporations superior to individuals in all business opportunities.[25]

This would continue in the conventions up to 1890. Delegates offered amendments accompanied by impassioned speeches that corporations ought not be granted special privileges except as they are beneficial to the public. Some of the most radical proposals were made at the 1878 California convention. One delegate thought the

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[24] Kentucky (1890), *Official Report,* 3726 (Mackoy).

[25] Pennsylvania, *Debates* (1872)*,* vol. 7, 769.

appropriate distinction was to limit corporate creation to those purposes where eminent domain needed to be exercised. He saw corporations being established for all sorts of businesses that, to his mind, did not need it:

> Let us not lend the dignity of the State of California to an incorporation organized for the purpose of gathering swill in the street and feeding pigs; let us not lend the dignity of the State to an incorporation for the purpose of establishing henneries to hatch chickens; but if we do make corporations, if we must have corporations for some purposes, and combined capital, then let it be for a purpose for which we can lend the dignity and the authority of the State to exercise the right of eminent domain, and let the right of eminent domain go hand in hand with corporations who are authorized to exercise these great powers of the State." All other businesses can be done with partnerships. Things are too impersonal, it and it would be better if there were personal responsibility. The state is too paternal, and it should become less so.[26]

Nevertheless, state practice had changed. Corporations would be chartered for a greater variety of purposes.[27]

Some delegates saw the need to justify state restrictions on corporate practices. They were concerned with protecting the right of private property, while still protecting the right to the state to regulate its domestic political economy. In 1867 at the convention in Michigan, a delegate made the private/public distinction as follows:

> The rights of the corporation in regard to the manner of using its capital may be affected by legislation; but if a corporation has $10,000, or $50,000, or $500,000, invested in a particular way, not one dime of that money can be touched by any legislation. A law that should attempt this would be an interference with the right of property. But as to the manner in which a corporation shall, under a general or special law, be authorized to use its capital, the corporation is subject to the right of the people of the State, acting through the Legislature, to control them as they control the natural persons of the state.[28]

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26 California, *Debates and Proceedings* (1878-9), 397 (Wyatt).
27 See Chapter Three, Tables 3.2 and 3.3, and accompanying text.
28 Michigan, *Debates and Proceedings* (1867), vol. 1, 178 (Pringle)..

By 1890 the calls for the protection of corporate property were ubiquitous as were calls for continued regulation. A delegate in Kentucky sought to justify regulation of corporations on the same basis as the state regulated natural persons.

> "A natural person is not exempt from the time he enters the world until he is put into his grave. The relations of the infant to his parents are regulated by statute, which fixes the time when he comes of age; how he may acquire title to his estate; how he shall gain entrance into any of the professions; in what manner he may contract marriage; how he shall have a remedy for wrongs done him by his neighbor; on what terms alone he may recover for keeping an aged or afflicted parent; at what rate he shall lend his money; when he may hunt or fish; what dividend he may receive if he invests in the capital stock of a turnpike or a bridge; what he shall charge if he keeps a ferry or tavern; when he is bound for is obligations; fixes his fees if he is made a servant of the people; says on what terms he may peddle; forces him to be vaccinated; fixed the limit to which he may go in controlling his own beast; lays down his tools if he owns a grist mill; sets a limit to the rates in the case of public warehouse; says when and how he shall cast his vote; takes his property for the public use; compels him to become a soldier in time of war; and provided for depriving him of his liberty if he will not engage in any pursuit and become a vagrant. All these things are matters of regulation by law, and the laws of the land can regulate the management of railroads.[29]

Legislative Control

The shift from special acts of incorporation to general laws of incorporation was a topic of debate at the 1867 Michigan convention. Two types of arguments were offered here. One was that special charters led to special favors, and thus led to an inherent unfairness. The other was quite simply that writing special charters took up an enormous amount of the legislature's time. Some delegates estimated that the legislature spent up to 1/3 of its time writing and passing special charters. As they contemplated eliminating special charters, many delegates sought to promote the economic development of the state, yet not concentrate power in too few hands. They

[29] Kentucky (1890), *Official Report,* 3714 (Beckner).

voiced concern that special grants were in effect monopoly grants.

Once the decision was made to require corporations to be organized according to general laws, the next question was whether the legislature should be permitted to offer special charters at the same time, and if so, under what conditions. There was a concern that under a regime of general laws there would be particular types of corporations that would not be able to be chartered. Thus there would need to be a set of provisions to allow corporations to be created by special enactment. The debate was over whether special charters should be passed by a legislative majority or by a supermajority. The task in the minds of some delegates then turned to trying to discern how each option would affect subsequent practice. Were a mere majority vote needed, would it be more likely that the legislature would restrict corporations at will (and possibly idiosyncratically), or would it rather be more likely to be co-opted by corporations seeking special favors? One delegate ventured that applications to extend corporate rights outnumbered those to restrict corporate rights by a ratio of 20:1. Thus he favored a supermajority rule to prevent abuses. After some contentious debate the convention settled on a rule that allowed the legislature discretion to grant special charters, but only with a 2/3 vote. This, it was thought, would help in preventing abuses where the legislature was bought by special interests.

This led to a remarkable six day debate over whether modifications of existing special charters could be made by a majority vote, or if they would also require a 2/3 vote. At issue was the problem that a corporation could be awarded by a general law, and then it could be amended in favor of the corporation at the expense of other corporations. A two-thirds rule would make it more difficult for a corporation to control the legislature and extract an unfair advantage. At the same time, however, it would make it difficult for the legislature to remedy grants that turn out to have been abused.

One delegate was concerned that "corporations should only be formed for the benefit of individuals and should "never transcend in its organization the interests of the body politic."[30] In his view, this meant that the legislature should maintain control over corporate charters, and consequently should be able to amend such charters by a bare majority vote. The 2/3 rule, he maintained, was divergent from "the great principle of republican government." This view was in contrast to those who thought that treating corporations differently from individuals set a troubling precedent:

> The question we have to decide is—shall we make distinctions in regard to rules for legislation, and have special rules for one class or branch of legislation, and a general rule for all other branches? Shall we provide in this organic law that the moment a question comes before the representatives of the people affecting corporate interests, there shall operate a rule entirely different from that which operates upon those questions coming before them which affect private, personal rights? Shall we provide greater protection and safeguards for "corporations other than municipal," that we throw around the private citizen in his rights of person and property?[31]

It seemed to this delegate that a 2/3 rule would protect corporate interests from the reach of the legislature. This was made more forcefully by the Chairman of the committee on corporations:

> ....we subject in great measure our most essential rights to the judgment of the people as expressed through their Legislature. There are to be found, of

[30] Michigan, *Debates and Proceedings* (1867), vol. 1. 185 (Burtch).
[31] Ibid., vol. 1, 180 (Williams).

> course in our Constitution, limitations upon the power of the Legislature with respect to personal rights; but individuals are constantly controlled by the general laws enacted by the Legislature. Why should corporations require greater security in this respect than is enjoyed by individuals? I am opposed to empowering corporations, if they can control a few men or a few votes in the Legislature, to resist successfully the adoption of any reform which may be proposed in a general law. I believe that our general legislation with respect to corporations has not yet attained the character of a fixed policy; and I do not deem it wise to require a two-thirds vote for the amendment of such general laws, believing that the interests of both the citizens and the corporation will be best protected if questions of this sort be left to the good sense of the people as expressed through the Legislature in the ordinary way.[32]

He thought the legislature was less likely to take away privileges and rights of corporations than it was to grant them additional rights.[33] Another delegate touched the heart of the controversy: "this power of amending charters is a two-edged sword, and a 2/3rds rule would mitigate against new restrictions on corporations as much as it would provide protections against unfair special privileges to be granted to a particular corporation."[34]

The Michigan convention decided to pass the 2/3 rule, in the form that whatever majority was needed for the original charter was necessary for legislative amendment or alteration of the charter. It is worth noting that this act of the convention took away a substantial portion of the legislature's activity. It also took away a substantial portion of its power to dispense favors. Incorporation by special act was a practice that was being phased out, but the phase-out caused great concern.

This issue, so prominent at the middle of the century, would not be repeated in later conventions, with one notable exception. Delaware continued the practice of

32 Ibid., vol. 1, 178 (Pringle).
33 Ibid.
34 Ibid., 182 (Norris).

special legislation up to its convention of 1897. At that juncture the delegates at the convention chose to end the sleepy status of Delaware corporation law. Said one delegate that supported general laws along with a prohibition on special acts: "It will certainly prevent one very great abuse and very great evil; and that is the lobbying of wild-cat schemes and corporations through the Legislature that would never have been given at the hands of the Court under a proper corporation law."[35] In addition, it would "shorten the term and expense of the Legislative session."[36]

Delaware delegates still sought to control their state economy at that relatively late date. A pro-corporate delegate argued against having a general law for all purposes, arguing that the legislature was competent in such a small state to to pass on desirability of proposed corporations. "Ours is a very small State. The Members of the Legislature are familiar with all parts of it; and it seems to me they are quite as well prepared to judge as to the desirability of these proposed corporations as any other tribunal."[37] He noted that in large states with diverse interests, this is not possible, and that the provisions forbids the legislature from granting corporations that might bring a particular industry to the state.

> We have no more important question which will engage the attention of this Convention, either in the committee of the Whole, or otherwise, than the question of corporations...I believe that the very best tribunal to pass upon these matters is the Legislative."[38]

35 Delaware, *Debates and Proceedings* (1896-7), 2100, (Burris).
36 Ibid.
37 Delaware, *Debates and Proceedings* (1896-7), 2098-9.
38 Ibid., 2099.

Purposes

No one disagreed with the provision that a corporation could only engage in activities clearly authorized in its charter. These purposes were typically very narrowly drawn. Thus, as noted in Chapter Three, a corporation chartered for the purpose of mining iron ore could not also smelt the ore without a change in the charter. Without the amendment, the corporation would be subject to *quo warranto* legal actions. The corporate consolidation that occurred at the end of the 19th century would require that corporations be allowed to engage in any otherwise legal business.

It is notable then that there were two attempts at the 1872 Pennsylvania convention to allow precisely that. One would have allowed any number of persons to associate for any business purpose, with limited liability.[39] Supporters thought it would help the formation of small corporations.[40] Interestingly enough, there was opposition both from anti-corporate and pro-corporate proponents. The former were concerned that it would disrupt and confuse settled law on liability. The language of the provision would apply to both wealthy corporations and small corporations. It would allow the wealthy to gain if a risky venture succeeded, but avoid the costs of failure. Limited liability, it was thought, should be up to the discretion of the legislature, and would be a monstrosity if applied to all businesses. It would abrogate liability provisions that gave laborers a lien on the corporation for work done.[41] The

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39 "Section 21. Any number of persons, upon making such publication as the Legislature may by general law prescribe, may associate themselves together for business purposes, with several liabilities proportionate only to their individual investment." Pennsylvania, *Debates* (1872), 635.

40 Ibid., 689 (Whetherhill).

41 Ibid., vol. 4, 638-9 (Buckalew)

objections by pro-corporate delegates was that if the state were to make individuals liable for amounts beyond what they originally invested, it would drive capital from the state. The individual must be liable to the corporation, and the corporation liable to the creditors, but not the individual shareholder to the corporation creditors. It seemed to these delegates that the latter situation might obtain under this law. Thus the section had little support, and after a rather lengthy debate, failed.[42] These questions about liability kept delegates from passing a section that would allow a general law for any purpose.

The second attempt came later in the session. A section that allowed any two or more persons to associate for any legal purpose, with limited liability, had been added on a second reading of the section. Thus it survived an initial vote on the floor. Intriguingly, the stated purpose of this bill was to aid labor. The provision would bring capital to the state, and allow men freedom of association. The partnership law, it was asserted, was inadequate to this task. Allowing any two or more men to incorporate would further the development of the nation, and also to solve the problem of capital and labor:

> Why, sir, the great question of this age, not only in this country but in Europe, is the question between capital and labor. It is the most fearful and most interesting question now agitating the public mind all over the civilized world. The proper solution of that question is the very system which we propose here. Capital and labor are not antagonistic. They have got into antagonistic positions; they fancy that their interests are conflicting; but they are not. They are the natural allies of each other. Capital can do nothing without labor; labor can do nothing without capital. They are natural allies, and the most effective way that I can image to solve this question is to furnish

[42] Ibid., vol. 4, 637-642.

facilities for uniting capital and labor.[43]

Delegates claimed that this was standard practice in New England, and one delegate read extensively from laws of Massachusetts, New York, and Ohio in support of passage.[44] It is worth noting, however, that while the proposal before the convention would allow incorporation for any lawful business, the provisions of the other states read by this delegate were for restricted purposes. Further, New York had double liability. In any case, it is notable that this effort, too, failed. The time when it would seem legitimate to allow corporations to engage in any line of business was still in the future.

Pennsylvania limited corporations to the operations specified in their charters, and to hold only such real estate as was "necessary and proper" for those specified purposes. The delegates inserted a provision allowing corporations to hold real estate to satisfy debts honestly contracted, and required courts to pass judgment on whether this was done in specific cases.[45] It is notable, however, that no one contested the notion that a corporation ought to be limited to purposes clearly stated in its charter.

This would change as the century progressed, as general laws of incorporation encompassed greater and broader objects. Nevertheless, even near the end of the century corporate advocates did not necessarily believe that there should be a broad general law for such. Said one such delegate at the 1897 Delaware convention, "I don't believe there should be a general law to incorporate everything." In particular, he

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[43] Ibid., vol. 7, 775-6, (Calvin).
[44] Ibid., *v*ol. 7, 764, 766, 770-1.
[45] Ibid., vol. 4, 610.

felt the state should jealously guard its power of eminent domain.[46]

Term Limitations and Real Estate Limitations

There were few discussions regarding limiting the term of existence. In the Pennsylvania convention the committee on corporations reported a section that would limit the term of existence of any corporation to 20 years. Only two delegates spoke, both against it. One argued that many firms had large sums invested in enterprises, and an arbitrary twenty year limit would force them to shut down, or to apply to the state again for a charter. This would cause inconvenience. The second delegate argued that the legislature in the prior year had nearly granted any number of men to associate for any legal purpose, with no time limit. He noted approvingly the actions of New York, of the New England states, of Ohio, and of England. The section was quickly rejected.[47] Thus although delegates recognized that corporations would otherwise have perpetual life, they declined to institute this restriction. This is striking when placed in contrast to stated reasoning for placing restrictions on real estate. It was perpetual corporate life that justified some real estate restrictions.

To the 18th century mind, land and wealth were nearly synonymous. The creation of intangible property eventually led to the removal of land from its privileged perch. Nevertheless, in the middle to the nineteenth century, land was still largely equated with wealth. No other form of corporate right was more emphatically or literally a property right. States placed different forms of restrictions on the right of

46 Delaware, *Debates and Proceedings* (1896-7), 3103-4.
47 Pennsylvania, *Debates* (1872), v. 4, 608-9

corporations to hold real estate, and justified their positions. There was general agreement that corporations should not be allowed to hold real estate beyond what was essential to their business. Otherwise, there was greater likelihood of the concentration of economic power. However, this led to a problem. Real estate was often accepted as payment for debts, and the question then recurred to how long the corporation assuming ownership of the property would be allowed to hold it. Defenders of corporations noted that in a depression it might be difficult to unload property, while others noted that without the limitation corporations could hold land off of the market for the purposes of speculation, to the detriment of the citizenry.[48]

The committee on corporations in the 1867 Michigan convention proposed to restrict the length of time which a corporation could hold lands that were outside of its purposes to ten years.[49] This policy found several supporters. One delegate asserted that the policy of the country was "against perpetuities."[50] Corporations were different from natural human beings. Natural persons perished, and with this, their property would naturally become dispersed among the inheritors. Corporations by contrast did not die. Thus theoretically they could accumulate landed property without limit. The purpose of the real estate restrictions was to remedy this difference between individuals and corporations. The accumulation of land in a few hands was detrimental to republicanism. Early experience of concentrated wealth, suggested one delegate, revealed "certain evils which induced our forefathers to believe that it was

48 Kentucky, *Official Report* (1890), 3652-5.
49 Michigan, *Debates and Proceedings* (1867), 210.
50 Ibid., 210.

more democratic, more republican, more consonant with the interests of the people, that lands should be subdivided into comparatively small tracks; that large masses of land should not be concentrated into the hands of a few individuals."[51]

Delegates were concerned with corporate practices that were seen as adverse to the development of the state. Railroad companies, especially, had been granted extensive lands. In Michigan, at least, they sometimes held onto land, speculating that it would increase in value. Because this kept land off of the market it retarded development, and this was seen as a public problem.[52] This was seem by some delegates as adverse to good policy. Others saw it as necessary in order to induce railroad development. Some argued, for example, that 10 years was not enough because often railroad building projects underwent years of delay before they were able to be completed. Such was the effect of the financial crisis of 1857-58, and such was the case with the Civil War.[53] Further, the reason why lands had increased in value was precisely due to the prospect of railroad construction. Some argued that it was impossible to force a corporation to sell, and that they would just find some legal device whereby the land was held in trust, to be sold later.[54]

Delegates were keenly concerned with how state industries would be impacted, and sought to ameliorate the effects for specific industries. One delegate noted that iron companies had need for a great deal of wood, in order to make charcoal for the

51 Ibid., 213. Some delegates sought to limit ownership of land to individuals as well as corporations.
52 This was very much the same sort of issue that Hurst notes in his study of the timber industry in Wisconsin during this same time period. James Willard Hurst, *Law and Economic Growth: The Legal History of the Lumber Industry in Wisconsin, 1836-1915* (Cambridge, MA: Belknap, 1964).
53 Michigan, *Debates and Proceedings* (1867), 220.
54 Michigan, *Debates and Proceedings* (1867), 220-1 (Hold).

smelting process. It would need to hold those lands for a much greater period than ten years. His concern was that such lands would not be permitted under the proposed amendment to the state constitution, to the detriment of industry in the state. The issue here was in part constitutionalization of the policy, and also the enactment of provisions that would be adverse to the economic development of the state.[55] Others were simply were opposed to any such restrictions, terming it class legislation.

Cumulative Voting

Cumulative voting is the practice of requiring more than one directors seat to be voted on by the shareholders at one time, allocating to each share as many total votes as there are seats open, and then allowing the shareholders to allot their votes as they see fit. Thus a holder of 100 shares in an election of 4 seats would have 400 votes that could be "cumulated" and applied to any one seat. This increases the odds that minority shareholders will have a seat on the board of directors. Without cumulative voting, 51% of the stock could control 100% of the seats.

It is important to remember that corporations were relatively closely held at the time. Shares of most corporations were not sold on stock exchanges, but rather were exchanged at offices of the corporation. Thus, while corporate shares were traded, it was much more like the modern day exchange of an automobile title, where there is a definite buyer and a definite seller. The purchasers of stock took a partial interest in a firm, and were often more closely connected with it than as mere passive investors.

[55] Ibid., 212 (Mussey).

The firm held an important part of his property in trust, and delegates thought it was important to respect the holder's property rights. Impersonal markets came later, with merger movement at the turn of the twentieth century.

The propriety of constitutionalizing cumulative voting proved to be one of the most discussed and contentious issues regarding corporations at the Pennsylvania convention of 1872. The idea was clearly novel to delegates, and they often did not understand how it would work in practice. To some it seemed undemocratic, and inappropriate: "It is a principle to constitutionalize the idea that the minority should govern."[56] Supporters, by contrast, thought that placing minority representation on the board of directors would be a way to check the Fisks and the Vanderbilts.[57]

Some delegates thought cumulative voting was a matter of public interest. They thought it would open up the otherwise secret deliberations of the board of directors. They felt that many of the abuses of the board resulted from the secret activity. The logic of cumulative voting was expected to give a minority of shareholders access to the deliberations of the majority. In this there was a conflation of private and public domains. The minority of the shareholders were generally not representatives of the state (the state by then invested in few corporations), but rather were private citizens acting in their private capacity. Yet the state was depending on these minority shareholders to open up, and thus prevent, the otherwise secret actions that constituted an abuse of public policy.[58] Said one delegate:

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[56] Pennsylvania, *Debates* (1872), vol. 4, p. 606.
[57] Ibid., vol. 4, 759.
[58] Ibid., vol. 4, 604-6.

> "These corporations have become very numerous. They are organized for carrying on a great variety of employments and business in our State; in fact a large part of the disposable capital of the State is embarked in corporate companies of some sort, and their management and administration, therefore, becomes a question of immense magnitude and consequence in our State. It is to the interest of the public, it is to the interest of the people in common that these corporations should be conducted upon sound principles, and with every guard which can be provided by the government against their abuse."[59]

The opposing side denied that this public concern would function as thus described. The public, rather, could protect themselves by initiating *quo warranto* legal actions; remedies could be found in the courts. Beyond that, the legislature had the power to amend, alter or repeal a charter, and this was sufficient protection for the public.[60]

Another concern was whether the state would be able to control certain private corporations in which it held minority shares of stock. One delegate noted that both the state of Pennsylvania and the city of Philadelphia owned shares in the Pennsylvania Railroad, and each elected a portion of the directors. With cumulative voting, it was thought that the Pennsylvania Railroad could become the tool of a political machine, particularly in combination with other minority shareholders. The reply was that cumulative voting guaranteed representation on the board, but the state would not be able to control the corporation merely due to cumulative voting. When votes are cumulated on one seat, the remaining seats will be uninfluenced by that minority.[61] Supporters asserted that cumulative voting was not appropriate for a political democracy, but nevertheless could be justified or corporations.[62] In

[59] Ibid., vol. 4, 605 (Buckalew).
[60] Ibid., vol. 4, 607.
[61] Ibid., vol. 5, 762-5.
[62] Ibid., vol. 5. 759.

democracies, it was thought, single member district voting would insure minority representation, something that might not occur in corporations.

Finally, some delegates suggested that cumulative voting would be abused by corporations that would more easily be able to engage in intra-industrial espionage. A corporation could place "spies" on the board of a rival corporation by merely controlling a small fraction of the stock. This, it was felt, would destroy unity of action and paralyze the administration of the affected company.[63] Proponents countered this by arguing that the rival corporation could protect itself: it need only place spies on the corporation that had placed spies on it.[64] The notion of promoting inter-firm spying struck opponents as a ludicrous public policy. It is significant in retrospect for indicating a lack of awareness or concern yet for interlocking directorships. Delegates in 1872 saw firms as competitors rather than colluders.

Cumulative voting passed in Pennsylvania, as it would two years later in Ohio. Interestingly enough, 16 years after that in Kentucky it still had to be explained to some of the delegates, despite nearly two decades of practice on which to draw. By contrast, in 1897 in Delaware, the cumulative voting section passed with no debate.[65]

Limited Liability

Limited liability was a major concern at all conventions in this study through 1890 (it did not arise at the 1897 Delaware convention.) However, the liability issues were different at the different conventions. California, in 1878, was the most radical

63 Ibid., vol. 5, 766.
64 Ibid., vol. 5. 759.
65 Delaware, *Debates and Proceedings* (1896-7), 2143.

of the states, imposing proportional, unlimited liability on shareholders. Limited liability seemed unjust to some, because it was a way of avoiding responsibility for debts. Further, a corporation with limitations on liability had advantages over individuals. The various proposals on liability were amongst the most contentious of the sessions on corporation law.

Pennsylvania had a limited liability provision prior to 1872, but it is worth noting that there was a proposal to impose double liability at the convention in that year.[66] It would make stockholders liable for debts at the time they held stock, even if the default came well after they had sold their shares. Only one delegate spoke on this provision, before it was killed. Making liability perpetual, he thought, would be a step back; constitutionalizing such a provision would be going back to the middle ages. He noted the prior history, that limited liability had commenced in Massachusetts, followed by New York and Ohio. England had passed a law that people might incorporate for any legal purpose, with the proviso that if it were a limited liability company, the word "limited" had to be in the name of the company, and on all correspondence and contracts, so that those contacting with it knew the status of the entity with which they dealt.[67] He argued that the state had suffered in comparison to other states, and that only in the past session that the legislature got rid it. While it was essential to require disclosure the limited liability status for all who might make a

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66 "Section 8. The stockholders of every corporation doing business in this State shall be individually liable for its indebtedness to an amount equal to the par value of the stock held by them respectively when such indebtedness was incurred; and this liability shall not be held to be a penalty, but shall be taken to be a part of the contract under which such corporation may transact business in this State." Pennsylvania, *Debates* (1872), vol. 4, 589.

67 Pennsylvania, *Debates* (1872), 589.

contract, he asserted that "Limited liability is the road to civilization."[68]

In light of the Pennsylvania proceedings, it is notable that a major topic of debate at the Ohio constitutional convention was the double liability provisions that had been placed in the state constitution since 1851. Some delegates argued that it had retarded development in the state. They compared favorably the economic success of the more industrialized Pennsylvania, where many corporations had been chartered with limited liability, to Ohio's more agricultural economy, where double liability was the rule. Supporters claimed that it was easy to avoid the double liability requirement via manipulation, and that it would thus be better to require simple limited liability and thus eliminate the inducement to shady dealings of this type.[69] Further, the original purposes for double liability no longer operated. Said one delegate, double liability was inserted in the 1851 constitution for purposes of

> "rendering corporations more liable to the public for the debts that they might contract, and to take away, so far as possible, any means by which they could, as it was said, swindle the public out of the debts which they justly owed, as it was contended, was largely done by corporations under the old Constitution, and under the old system of doing things in Ohio."[70]

In his judgment, it did not work, and did in fact hinder development.

There was clearly and a lack of reliable data on the impact of limited liability. Thus there was a disagreement over what the future might hold. Proponents of double liability typically denied it hurt the economy. One even claimed that local businessmen were in favor of double liability, because it gave them greater assurance

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68 Ibid.
69 Ohio, *Official Report* (1873-4), 2366 (Alexander).
70 Ibid., 2367 (Dorsey).

that the businesses they dealt with were solvent, and because double liability would concentrate the minds of operators to avoid having to pay for losses, thus inducing them to run their businesses better.[71] A proponent thought that limited liability had been a hindrance, but that this was a good thing, because people would be less careful without the double liability.[72]

Delegates connected double liability to the problem of information acquisition. Said one delegate: "I believe, that with a well-guarded law which would require, instead of the liability of stockholders, that there should be an ample amount of stock paid up, and a system of published reports, there would be far better protection to the people of Ohio."[73] Reports made under oath, with the potential punishment of perjury for false statements were seen as an appropriate substitute for double liability.[74] The proponents of double liability discounted the possibility of getting accurate reports from corporations.

> It is just as impossible to compel corporations to a full, fair and complete disclosure of their affairs in a way that will let the public know or the people that are not fully conversant in the matter, how they stand, as it is to make them understand Sanscrit. It never was done and never can be done in any judiciary, to complete the disclosure of the affairs of corporations.[75]

Further, double liability would protect creditors. Shareholders had some idea what was going on in the corporation; at the very least they had voting power. Creditors, on the other hand, were in the dark, and double liability could protect them against

71 Ibid., 2372-3.
72 Ibid., 2371 (Voris).
73 Ibid., 2341 (Herron).
74 Ibid., 2366 (Alexander).
75 Ibid., 2369 (Tuttle).

fraud.[76] It would also protect the ordinary person.

> The longer I live the more I am convinced that there is a large class of persons who, through ignorance of weakness, are not capable of protecting themselves against hard and dishonest men. Those who are wiser, richer and stronger than the mass of humanity, owe protection to those who are less fortunate than themselves. Society ought not to be conducted like a bank, with the sole view of making the largest sum of money out of a man, but it ought to be conducted with some regard to the weakness of human nature.[77]

By contrast, the more radical California convention of 1878 went further. There it was proposed that shareholders should be individually and personally liable for the proportion of debts incurred at time he was owner of the stock. In other words, liability would not end with sale of stock:

> It is not joint and several liability, and so a shareholder that had paid once, would not have to pay again. In practice, many stockholders are insolvent at the time of corporate insolvency, and this will protect creditors; just because one is insolvent does not mean that others do not have to pay. Rather than drive capital out of the state, it will encourage responsible capital formation, likely at smaller amounts, with a reserve fund set up within the corporation in order to protect the stockholders. The corporation will act more responsibly.[78]

Twelve years later, in Kentucky, double liability was again debated vociferously. Delegates even at this late date did not see how one could justify having treating a corporation differently than a partnership.[79] Proponents of liability argued that many corporations are speculative, and that additional liability was a way to protect creditors.[80]

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[76] Ibid.

[77] Ibid., 2387 (Page).

[78] California, Constitutional Convention (1878-9), *Debates and Proceedings of the Constitutional Convention of the State of California: Convened at the City of Sacramento, Saturday, September 28, 1878*, E.B. Willis and P.K. Stockton, official stenographers, 3 vols. (Sacramento: State Office, 1880-1881), 383 (Webster). Hereafter referred to as "California, *Debates and Proceedings* (1878-9)."

[79] Kentucky, *Official Report* (1890), 3739-40.

[80] Ibid., 3737.

> But we do ask that these gentlemen shall stand upon the old common law liability of partnerships. Is not that honest? What is a corporation? A corporation is a combination of individuals with certain franchises granted by the State, and when you come to its liability, why should not the individuals composing that corporation, be as liable for the debts as the individuals who compose a partnership. That is not requiring anybody to go security. It is simply requiring them to put up their estate as security, as every other individual puts up his estate when he engages in an enterprise, or when a combination of individuals engage in a business as a partnership.[81]

Despite such arguments, the provision was not successful. Opponents of double liability argued it would retard development in the state. As to why Ohio has double liability and Kentucky ought not, an opponent noted, "The State of Ohio stands with the Ohio river on one side and with the lakes on the other, and the great traffic of the nation has had to pass within that narrow limit of two hundred and fifty miles. It is because she has the means of development that Kentucky has not had......Her geographical position is superior to ours."[82]

In Delaware, in 1897, a proposed section to the Constitution would have required, when stockholders had paid a portion of subscription, and the corporation could not pay its debts, that the shareholder be liable up to the full amount they had subscribed. The language was somewhat unclear, so that it could have been interpreted to require stockholders to pay over and above the amount of stock subscribed. There were objections to limiting the legislature, which was fully competent to deal with the topic. The delegates decided on this last course. Extra liability on shareholders did not survive the century.[83]

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[81] Ibid., 3745 (Straus).
[82] Ohio, *Official Report* (1873-4), 3744 (Young).
[83] Delaware, *Debates and Proceedings* (1896-7), 2144-9

Director Liability

The debates on shareholder liability directly impacted debates on director liability. The delegates tied the issue of liability to the question of information, and noted the advantages directors had over shareholders in collecting information about the inner workings of the firm.[84] At the 1874 Ohio convention one delegate noted that British law granted limited liability to shareholders so long as official papers identified the firm as "Limited" (Ltd.). This was combined with unlimited liability for directors. This delegate argued that the British model should be copied in order to insure directors remained true to their fiduciary duty.[85] The law of Great Britain, the greatest commercial nation on earth, was an example Ohio ought to emulate.[86] Director liability, then, was a way to ensure responsible management. Nevertheless, it did not make it past the proposal stage at that time.

Director liability was by far the most contentious issue at the 1878 California convention, one on which a significant proportion of the delegates spoke in a debate lasting several days. The proposed section would make directors and trustees jointly and severally liable for moneys "embezzled or misappropriated." The word "misappropriated" caused particular concern. It could be interpreted, some thought, as making directors liable for actions of subordinates. Cashiers could commit fraud, for example, and the directors would be personally responsible.[87] The chairman of the

84 See, for example, California, *Debates and Proceedings* (1878-9), 389 (Rolfe).
85 Ohio, *Official Report* (1873-4), 2374 (Voris)
86 Ohio, *Official Report* (1873-4), 2374-2375 (Hoadly) Cites Justist, volume VIII, part 2, 1862, pp. 83 and 84, Statutes, 25 and 26 Victoria. Also, 30 and 31 Victoria, Chapter 131. (Brius. Stats., 30 and 31 Vict., 1867, pp. 1372 and 1373.
87 California, *Debates and Proceedings* (1878-9), vol. 3, 396.

Committee on Corporations vehemently opposed it, as it would make an innocent man responsible for the crimes of the guilty.[88] Another delegate argued that directors are mere agents of the shareholders, and that it was unjust to make them responsible for actions of subordinates.[89] Furthermore, while the rule might make sense for a small private business, it could not work to make directors personally liable for employees actions in large firms.[90] It was, in their view, a thinly veiled attempt to outlaw all corporations, period.

Proponents of director liability argued that directors, not shareholders, were responsible for abuses, and thus should be made to pay for those abuses. Further, directors were in a position to know what was going on in the firm, including the actions of employees. Thus these delegates effectively treated directors as principles, rather than as agents of the shareholders. The innocent shareholder ought not have to pay what the trustee was designated to prevent.[91] The directors were not, and never could be, "innocent." Thus the "Sword of Damocles" ought to discipline both minority and majority directors alike.[92] With unlimited director liability the corporation would be more responsible, figureheads on the board would be eliminated, and the fleecing of widows and orphans would stop. Those who appointed the cashiers ought to be responsible for their actions.[93]

Those who urged moderation wanted it only to apply to directors that had

[88] Ibid., vol 3, 404 (Estee).
[89] Ibid., vol. 3, 407-8 (Edgerton).
[90] Ibid., vol. 3, 396.
[91] Ibid., vol. 3, 406 (Freeman), 411 (Reynolds).
[92] Ibid., vol. 3, 407 (Johnson).
[93] Ibid., vol. 3, 397, 404.

committed wrongs. Thus one proposal was to strike out the word "misappropriated," which could be interpreted broadly, and include only the word "negligence," which would indicate responsibility. This would protect the honest director who discovered fraud and brought it to light, and who might otherwise be liable under this provision.[94] Nevertheless, the efforts to moderate this section failed, and the directors were held responsible for moneys "misappropriated."

Twelve years later a similar argument was tried in Kentucky:

> I believe that those who manage these corporations ought to be held to a higher liability than the general stockholder, whether it be a joint stock company or a corporation for the transaction of a mercantile business or any business of that sort....I believe it is our duty to check that character of fraud. If it can be checked it ought to be checked, and I think, in making those who manage the concern liable more heavily than those who do not manage, we, in some measures, check that system of gambling in corporations.[95]

There was little debate, and the proposal fell far short of a majority. Yet out of the California debates we see nascent beginnings of the shift where directors would be treated as trustees rather than as agents, and shareholders would be treated as investors rather than as owners. This paradigm shift would a key element of the twentieth century model of the corporation. It is ironic that the most vehement opponents of the corporation made this argument. They justified it as they sought to impose unlimited liability on the directors.

Liability of the Corporation

There is a third area of liability germane to corporations, that of the liability of

94 Ibid., vol. 3, 405.
95 Kentucky, *Official Report* (1890), 3777.

the corporation itself. In Pennsylvania the committee on corporations reported out a section that would designate the franchise, rolling stock, and all other movable property as personal property, and thus liable to execution and sale for corporate debts.[96] This led to significant opposition from delegates who were convinced it would be the end of all corporations. A creditor could sue, have the sheriff seize the railroad cars, locomotives, or track of a railroad corporation, and thus cripple its operations. This seemed absurd to many members. The franchises would be worthless without the constituent parts of the operation.[97] This led to a long speech by the Chairman of the Committee on Corporations, Mr. Woodward. This speech is revealing of the mindset of the proponents of this section:

> How government shall deal with the debtor portion of the community has always been a question in political science, and is presented now in the form of this section. The community consists of natural and artificial individuals; of persons and corporations. The government deals with natural persons after this fashion: In the original charter of William Penn lands where made chattels for the payment of debts; all interests of the citizen where made liable for his debts; but the government in its humanity exempts a very small portion of the individual's possessions. It leaves a man a bed, a cow, a stove and a Bible; and it does not leave him much else....
>
> Now, the question is, how shall it deal with those artificial beings with the production of whom the Almighty had nothing to do, whom we have made, the creatures of our own hands? Shall we subject them to the same rule to which we subject other people, black and white, male and female; or shall we lift them up to a higher plane and exempt all their available property, because of the good they are supported to do for the community in their corporate character?
>
> I suppose the committee of which I have the honor to be chaiman....in recommending this section intended to put corporations upon the same level as human beings, and to subject all their property to execution for their debts, not thinking it work while to make that sort of exemption that is made in behalf of other poor debtors.....

[96] Pennsylvania, *Debates* (1872), vol. 4, 611.
[97] Ibid., vol. 4, 612-14.

> Now, what is the answer to it? Pay your debts, and then your property will be safe. Pay your thirty dollar debt, if you owe a man thirty dollars honestly and fairly. There is no more reason, in the nature of things, why a great railroad company should not pay that creditor than there is why I should not pay my creditors... [98]

The reply to this was that corporations mortgage property, and thus promise that property to creditors, who have the first claim on it. Such a provision might conflict with this. Thus, corporations are liable for their debts, but the methods of collection must thus necessarily be different. At the end of the day delegates balanced the proposition of treating individuals and corporations the same with the counter that railroad development in remote areas of the state were more likely if the corporations were protected. All could appreciate the remarkable advance that railroads afforded. It enabled development of the interior of the state that otherwise would have been impossible.[99] The section did not survive.[100]

Foreign Corporations

"Foreign" corporations, in the 19th century, referred to corporations chartered in other states, as well as those in foreign countries. States permitted foreign corporations to operate within their state by the practice of comity. They did so with the understanding that corporations chartered in their own state would reciprocally be allowed to operate in the other states. The precedent for comity occurred before the

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98 Ibid., vol. 4, 617 (Woodward).

99 Ibid., 620-624.

100 A related provision would have made all corporations liable for injuries resulting the actions of their agents and employees. Some delegates commented that it merely replicated the common law rule. Others commented that the provision replicated a section elsewhere in the proposed constitution, and it was rejected in fairly short order. *Ibid.,* vol. 4, 590-2.

wide practice of cross state corporate operations. It was impractical to refuse capital that sought to be productive within the state.

Foreign corporations presented special problems for state legislatures. These problems grew as the transportation infrastructure needed to build a national market grew. One set of problems had to do with foreign corporations that did business the state. Delegates were concerned that citizens of the state be able to sue that corporation, but to do so citizens first had to know where to find the corporation. In 1872 Pennsylvania debated a section that required foreign corporations to have a known place of business in any county or city in which said business operated, along with an agent upon whom process could be served.[101] Some members objected to this as overly burdensome. Insurance company salesmen, for example, traveled from town to town, and it would be uneconomical to have an agent in every city.[102] The purpose, of course, was to insure that foreign corporations could be served with process within the state, insuring that citizens of the state did not have to leave to state to sue. The question then was, how many authorized agents should each corporation have? The convention chose to require at least one, but leave it to the legislature as to how many agents would be required.[103] Another provision at the same convention would have required firms chartered in the state to have a majority of its directors be residents of the state. Without it speculative foreign corporations from other states could "come in here, form companies under our mining law, carry away our coal, manufacture iron,

[101] Ibid., vol. 4, 609.
[102] Ibid., vol. 5, 770.
[103] Ibid., vol. 5, 775.

and appropriate our resources, contract debts, and when we pursue them into their own States meet us with some technicality....and defeat the honest creditor of Pennsylvania."[104] Opponents suggested it would lead to "straw men" on the Board.

For a foreign corporation, establishing and paying for an authorized agent with a known place of business could lead to considerable expense. Many delegates thought all foreign corporations should do so, and this provoked debate at all of the conventions, including the Delaware convention of 1897. The issue surrounded in part whether the state could and should protect domestic manufactures by restricting foreign corporations, and the extent to which the people of the state benefited from the increased competition from corporations chartered outside the state. Delegates agreed that requiring there to be an agent on whom process could be served made sense for insurance companies, but not necessarily for a number of other companies, many of which were small, or which irregular operations within the state.[105]

Individuals, of course, did not need an agent. A person could act on his own account, but corporations could only act through their agents. Further, corporations derived special benefits which the state could regulate. Said on delegate:

> "Private people can do as they please and take their own chances. But here we have given certain privileges to corporations, and we withhold certain privileges from corporations located in this State; that is, the domestic corporations are subject to be served with process while the foreign corporation having no agent here cannot be served with process in this State. I do think it is a great hardship for the people of this State that they cannot have that poor privilege of somebody against whom they can bring suit, if they have been wronged."[106]

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[104] Ibid., vol. 5, 771 (Woodward)
[105] Delaware, *Debates and Proceedings* (1896-7), 2153-5.
[106] Delaware, *Debates and Proceedings* (1896-7), 2158.

The presence of foreign corporations impacted state economies. This became an issue in 1874 at the Ohio convention. Two issues arose here. One concern was the influence of these corporations in extracting the wealth of Ohio, and sending it elsewhere. The second was that some foreign corporations were able engage in activities that Ohio corporations could not:

> They incorporate themselves in the State of Pennsylvania, and the State of New York, and the State of Connecticut, and all the States of the Union, if you please, and beyond the great ocean; and then they send their agents—they don't send their boards of directors—but they send their agents and establish agencies in all our cities and towns....(They) engage in the general transaction of business, just exactly, to all intents and purposes, as they are at home, and just as our own corporations are, with the single exception that they are not subject to our laws in any respect, that is to say, those that are peculiar to corporations. They enjoy all the privileges of foreigners, all the benefits of being created by foreign law only, and at the same time every benefit that they could have if they were incorporated in this State.[107]

The most pressing issue was venue selection for legal disputes. A citizen of Ohio could sue an Ohio corporation in Ohio. Foreign corporations, however, could remove the case to federal court. All delegates who spoke on the issue conceded that state courts were more timely, convenient, and cost effective than federal courts. Further, the federal courts were only in the big cities, such as Cleveland and Cincinnati, and travel to those cities could be a considerable hardship for a citizen in an outlying area of Ohio. Thus many members wished to make sure that foreign corporations consented to suits only in the state courts. The problem was exacerbated by the behavior of some foreign corporations. They as a regular practice escaped payment of damages by removing disputes to the more cumbersome and costly federal courts.

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[107] Ohio, *Official Report* (1873-4), 2352 (Tuttle).

Thus, foreign corporations stood, in the estimation of several delegates, on a "higher plane" than domestic corporations. This seemed to them a patently perverse policy; the state should be favoring domestic corporations, not foreign corporations.[108]

Foreign corporations sometimes acted outside the authority of the state. One example cited was a railroad corporation that had been chartered in Ohio and had condemned lands using powers of eminent domain granted by the state. It abused these powers and was sued by the state in a *quo warranto* action. The corporation escaped prosecution by dissolving the Ohio corporation, and selling the assets to a much larger foreign corporation. It then continued to do business in the State. In another case, the Pennsylvania Company acted as a holding company for the Pennsylvania Railroad, both chartered in Pennsylvania. It controlled rates in Ohio, and was more able to "corner" segments of freight markets, and manipulate them to gain excess profits.[109] Delegates sought to control such abuses via statutory law.[110]

Many delegates asserted that the state had the authority to decide whether to let a foreign corporation in at all. The state, they asserted, could make the requirement that foreign corporations consent to the jurisdiction of state courts as price to be paid for being permitted to do business in the state.

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[108] Note, however, that this same dynamic would also work in every other state that had efficient state courts in comparison to inefficient federal courts.

[109] Ohio, *Official Report* (1873-4), 2352-5. "Corner" here means not merely to have a large market share, but to "corner" shippers at key times in order to charge rates much higher than otherwise customary.

[110] The solution to this voted in the new constitution was to allow foreign corporations to do business in the state, such that foreign corporations shall be "subject to the same regulations, limitation and liabilities as like corporation of this State; and shall exercise no other or greater powers, privileges or franchises than may be exercised by like corporations of this State; nor shall they have power to condemn or appropriate private property." Ohio, *Official Report* (1873-4), 3554; 1873 Ohio Const. Article XII, Section 7.

> Now, the power being conceded that the State of Ohio has the right to prevent any foreign corporation from doing business in this State, the question then arises, have we not the right to determine when we shall exercise that authority, and under what circumstances? It seems to me that it is not the business of any other State of this Union as to what the reasons are or what the policy is which shall induce us to exercise that power; and whenever we shall determine that we will exercise it, no other power has the right to interfere or say aught against it. It is left to us entirely to determine that question. And when we shall say to any corporation doing business in the State, you do this thing and your power to do any business in the State of Ohio will end, have we not the right to do so?....I ask if this is not a good reason why we should compel no citizens of the State of Ohio to go outside of their own counties for the purpose of enforcing his rights against these corporations?[111]

This ran into potential conflict with Article III of the Federal Constitution, which provided that federal jurisdiction extended to "controversies between a State and a citizen of another State; (and) between citizens of different States." For jurisdictional purposes, corporations had been treated as "persons" under Article IV protections ever since the 1809 Supreme Court decision of *Bank of U.S. v. Deveaux*.[112] Further, the Supremacy clause of Article VI made federal law superior to state law when the two were in conflict. Were states allowed to force corporations to give up the right to sue in federal court, it could have impaired building a truly national market. One delegate cited a Michigan district attorney's report where he asserted it would almost certainly ruled unconstitutional by the Supreme Court of the Unites States: "Let, then, any State apply to all the business within it, a like law, and there results, under this doctrine, a wavier of a right to sue in the Federal courts, nothing comparatively would

[111] Ohio, *Official Report* (1873-4), 2492-3.
[112] *The Bank of the United States v. Deveaux et al*., 5 Cranch 61 (1809). In *Paul v. Virginia* 75 U. S. 168 (1869), corporations were not considered to be persons within the meaning of the privileges and immunities clause of Article IV of the Constitution. Nevertheless, they had the right to have cases adjudicated in federal courts.

be then left, and the several State Legislatures have practically terminated the national judiciary, as a court of civil jurisdiction for private suitors."[113] The Supreme Court was the final protector of the national market, and the limit of state power would be defined there.

The limits of state capacity to control foreign corporations grew as the century progressed. Even as early as 1874 the Ohio convention note that a coal company with a Kentucky charter, had been created entirely for the purpose of engaging mining coal in Ohio. It was a fraud, but Ohio already had passed a law allowed certain specified types of mining companies to "take, hold, and convey such real and personal estate as is necessary for the purpose for which it is incorporated; and may carry on its business, or so much thereof as is convenient, beyond the limit of this State, and there hold any real and personal estate necessary for conducting the same."[114] By thus allowing Ohio to "spawn" corporations in other states, Ohio was not on good legal grounds to restrict other states from doing the same. By 1890 the problem was more acute. A delegate at the 1890 convention in Kentucky noted that

> "the law of West Virginia is liberal with reference to corporations, and there are corporations doing business in Ohio under West Virginia charters. There is one very large corporation in Ohio formed under the laws of New Jersey. Its object in going to New Jersey in incorporate was this: After looking over the state laws of the various States, the persons proposing to form it found that, under the law of New Jersey, by paying a certain tax or license for the privilege of becoming a corporation, the corporation would be exempted from tax thereafter on its franchise. It was a certainly as to what it had to pay."[115]

This sort of logic then impacted many arguments. It was invoked by those

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[113] Ohio, *Official Report* (1873-4), 2496-7.
[114] Ibid., 2376 (Hoadly).
[115] Kentucky, *Official Report* (1890), 3738 (Mackoy).

opposed to to limits on real estate acquisition by foreign corporations in Pennsylvania in 1872 ("this is a relic of barbarism"),[116] and by those opposed to extra liability in California in 1878, and in Kentucky in 1890. As one California delegate noted, additional liability requirements in California would place domestic corporations at a disadvantage relative to foreign corporations: "We would discriminate against ourselves."[117]

In 1897 Delaware was still a sleepy backwater at the edge of the industrial metropole. Delegates were aware, however, of practices in nearby states, including her neighbor directly to the north, New Jersey. New Jersey by that time had begun her policy of seeking to attract corporations to take out charters even when they had no operations within the state. Delegates at the Delaware convention argued that a liberal corporation policy would be good for to the state:

> The wisdom of this liberality of the laws toward corporations is shown most strongly in this New Jersey case. I imagine there is no state in the Union that has laws more favorable to corporations than the State of New Jersey—not only corporations which do business in the State of New Jersey go to Trenton for charters, but corporations all over the country are operating under New Jersey charters;"[118]
>
> Suppose New Jersey did not get this nine hundred and fifty-seven thousand dollars a year from its corporation taxes and franchise fees, where else would it come from? It would have to come out of the pockets of New Jersey. The people would have to pay it if these outside, and domestic corporations did not pay it....
>
> I want our State to reach the highest possible point of development. I do not want to give unjust powers to corporations. I want the Legislature, or whatever tribunal has the granting of them, to use reasonable and proper care.

[116] Pennsylvania, *Debates* (1872), vol. 4, 609.
[117] 1878 CA CC 384 (Wilson)
[118] California, *Debates and Proceedings* (1878-9), vol. 3, 384 (Wilson).

> But if corporations can be induced to come to our State to take out their charters and pay their money into our State Treasury and relieve our people from taxation....I would like them to come here. [119]

Delaware would copy the New Jersey law in 1899, two years after the constitutional convention. She would offer laws similar to New Jersey, but at a lower price. That was only possible with the relaxation of restrictions on corporations that occurred at the 1897 convention. Delegates argued that a liberal policy might contain some risk, but held out the possibility of a significant reward. The exchange of the following two delegates, both proponents of liberal incorporation, is instructive.

> Robert W Dasey: If we undertake to go too far, there is danger of driving capital out. Capital goes where it can invest under the most advantageous terms. Capitalists are not so philanthropic as to invest for the benefit of communities, unless they can realize some benefit therefrom.
>
> If we can be liberal and protect our citizens to the same extent as they do in New Jersey and make it so that people can come here and get acts of incorporation and pay for the privilege, through and by which we can replenish our treasury, I do not know but it is a very good thing to take some little risk; for I think we are going to need some source to draw from. A continual draft from a limited supply will eventually exhaust the source.
>
> William Saulsbury: We could afford our penitentiary then.[120]

A blunter statement of state purposes in a federal setting would be difficult to find.

Decline of State Capacities in a Changing Political Economy

The impact of tradition on the construction of political economic regulations troubled many minds. Delegates recognized the role of the state in the creation and regulation of economic affairs. They sought to justify practice as it has been handed

[119] Delaware, *Debates and Proceedings* (1896-7), 2135-2136 (Saulsbury).
[120] Ibid., 2139.

down, and to justify too new regulations to be promulgated.

> These laws are the outgrowths of the business experience of long years. Law is not absolutely created or carved out of the head of any man. It grew from the customs and usages of merchants long preceding adjudication by the Courts.
>
> Take by way of illustration the rules and regulations of mines. These mining rules and customs grew from necessity, from the progress and industry of the State. The miners made their own rules and regulations, and afterwards the Legislature adopted them and crystallized them into law, and the Courts administered them and proclaimed them law. Take the customs of merchants in all the different branches of grade, and the same thing appears, for all these customs and usages contribute to the making of the law."[121]

The questions that arose in the political economy were pressing and new. "The great railroad questions of the nation are of recent origin—nothing old, nothing historical. There are no precedents that are not of the living present; we can see it all around and about us. We don't go to any old musty tomes to find out what the opinions of our fathers were as to railroads, for they had none."[122] Mr. Estee, the chairman of the 1878 California convention committee on corporations noted

> We are aware, sir, every thoughtful man everywhere must be aware, that at this time the wagon, the old state coach, the old time-honored means of transportation of freight and passengers, have passed away forever. That a new era has dawned upon the country, almost without our knowledge and in less than a generation....The political and financial power of railroads in the United States are immense, and have become a grand *imperium in imperio*—a government within a government, a power within a power, greater than the mightiest, grander and more colossal than any other financial institution hitherto known in the history of civilization.[123]

A new mindset was needed. Estee argued that combination and monopoly were inevitable, and that government could not stop them. Further, competition could also not exist. Following Charles Francis Adams, he argued that regulated monopoly was

[121] California, *Debates and Proceedings* (1878-9), vol. 3, 384 (Wilson).
[122] Ibid., vol. 3, 379 (Estee).
[123] Ibid., vol. 3, 377 (Estee).

replacing unbridled competition. Therefore the only practicable solution was governmental regulation.[124] Yet the legislature was not competent to deal with these issues. It only met for a short time every other year. A commission could be staffed with specialists that could inform themselves properly. Further, a commission was less likely to be influenced by money, which would inevitably tempt legislators. Legislators had proven to be incapable of questioning businessmen, and the new business man crossed party lines. Or, as he quoted of Jay Gould (from Adams' *Chapters of Erie*) "In Democratic districts I am a Democrat; in Republican districts I am a Republican; in doubtful districts I am doubtful: but I am always for Erie."[125] A new model was needed, and new procedures enacted.

States had authority to regulate corporations through their police powers, and most delegates recognized this. The police powers were broad, and most delegates contented that they could be exercised without infringing on corporations vested rights. Mr. Estee, the chairman of the corporations committee at the 1878 California convention cited *Munn v. Illinois* (1877)[126] as definitive that the state indeed could regulate corporations via the police power. It was appropriate for the state to regulate the corporation. However, he noted that while the legislature had the right to regulate railroad rates, it was not equipped to do so. The only solution he considered viable was a permanent commission.[127] The regulatory solution began first with railroad

124 Ibid., vol. 3, 378 (Estee).
125 Ibid., vol. 3, 379-80 (Estee).
126 94 US 113 (1877). Munn v. Illinois upheld states rights to regulate grain elevators, as they were businesses "affected with the public interest."
127 California, *Debates and Proceedings* (1878-9), vol. 3, 379 (Estee)

regulation, but as a general rule did not extend to all corporations until the twentieth century.

Twentieth century regulation, however, would not be based on state incorporation law. Rather, it would be based on federal antitrust law. Antitrust law is reactive, and as a general rule, does not threaten corporations with their very existence. Just as importantly, the federal government was a limited government of assigned powers. The extent of its antitrust authority had to overcome both a tradition of limited government, and the oversight of the Supreme Court. Federal activity was halting. The Sherman Act was interpreted narrowly in the *Trans-Missouri* case of 1897 by not making distinctions between reasonable and unreasonable restraints of trade.[128] This limited federal capacity to permit reasonable, but not unreasonable restraints. The court retained this interpretation of the rule of reason until the *Standard Oil*[129] and *American Tobacco*[130] cases of 1911, thus broadening the application of the Sherman Act.[131] The conflict over the extent of federal regulatory authority under the Sherman Act was conducted in the wake of a decline in state capacity to regulate the corporation via statutory law.

Old conceptions of value as static gave way to the new economic reality. In the latter years of the century delegates were concerned with fraudulently inflated stock values that were dumped on unsuspecting purchasers. Part of the problem was

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128 *U.S. v. Trans-Missouri Freight Association,* 166 U.S. 290.
129 *Standard Oil v. United States*, 221 U.S. 76.
130 *American Tobacco v. United States*, 221 U.S. 179.
131 See Martin J. Sklar, *The Corporate Reconstruction of American Capitali*sm, *1890-1916.* (New York: Cambridge University Press, 1988), 127-154. Hans Thorelli, *The Federal Antitrust Policy: Origination of an American Tradition* (Baltimore: Johns Hopkins Press, 1955).

discerning the true value of intangible objects. One solution adopted by states was to forbid corporations from issuing stocks or bonds, except for money actually paid in, labor actually done, or personal property acquired. This led to several objections at the 1897 Delaware convention, though it had been relatively uncontroversial before. One complaint was that it would restrict corporations from making using their credit to make purchases for goods designated for future delivery. A railroad, for example, might want to make a contract to purchase a railroad car scheduled to be delivered in the future, and wish to issue their credit to make payment for it. The problem is that the car is not yet made, and the law required actual property to be received. To meet this objection, delegates removed the words "bonds" out of the section, although stocks were still included.[132]

More fundamentally, however, was the problem of setting values on intangible objects. That included the value of stocks themselves. Many delegates had a notion of a fixed value for a good or service, and a fixed "par" value for the shares of a corporation.[133] Speculation was considered to be unjust market manipulation. The legislators were confronting a challenge to orthodox modes of valuation, and of placing value on intangible assets. The change in mindset that from one of fixed valued to that of value dependent on vagaries of the market was not yet complete, but in Delaware in 1897 we can see examples of an evolution of mindset to a modern conception of property:

A great many things that a company needs and are essential for its

[132] Delaware, *Debates and Proceedings* (1896-7), 2128 (Bradford).
[133] Kentucky, *Official Report* (1890), 3654-7

> operations, have no market price. That is almost without exception applicable to the whole subject of patent rights. Patent rights have no market value—not one in a million has market value....It is a thing that is not to be sold on the market. The only thing that can have a market value is a thing that is customary to be sold in the market. Each patent right is separate. This patent may be worth one million of dollars, ant that patent right may be worth one dollar; one may be worth one million dollars intrinsically if you work it, but nobody knows about that, and it is impossible to have any market price placed upon it. If you put in "market value" there is a vagueness of the words, "actual value."
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> I sympathize with the object of my friend from Milford....has in preventing the dealing out of stocks and bonds for things at fictitious prices, or fictitious values....That is the thing we want to abolish; but in doing it, do not let us fall into the error of saying that they shall buy nothing except at its market value.[134]

The solution amounted to state restraint in the valuation of goods. It could legislature against fraud, but its creation, the corporation, was moving beyond the states capacity to legislate in this area, despite the proclaimed right of states proclaimed to do so.

Conclusion

States were deeply involved in regulating their local political economies in the nineteenth century. The debates in the constitutional conventions over the propriety of various regulations is a testament to this fact. Delegates sought to promote the economic condition of their state, while still maintaining state control. They justified state action with the artificial entity theory.

The problems delegates faced at the end of the century were different from the problems they faced in 1867. In 1867 legislatures were able to control domestic

[134] Delaware, *Debates and Proceedings* (1896-7), 890-1 (Spruance).

corporations via statutory limits. By the time the national market was constructed at the end of the century, foreign corporations had great latitude to impact domestic state economies. The states capacity to discipline foreign corporations was limited. A national market for corporate charters increased the number of foreign corporations and further reduced state leverage.

When the Supreme court confronted orthodox legal doctrine that no longer functioned in the modern corporate economy, it searched for a new doctrine under which to operate and adjudicate disputes.[135] When the states confronted the same economic transformation, the exigencies of federalism led to the decline of state authority to discipline the corporation. Instead, authority over the corporation removed to the federal government. Corporate regulation would depend on federal capacity and federal will. The vagaries in the enforcement activity of the various administrations from one Roosevelt (Theodore) to another (Franklin Delano) are witness to this dynamic. In any case, antitrust enforcement activity by the federal government had to proceed without the use of statutory law as a weapon to threaten the corporation.

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[135] *See Horwitz, Transformation in American Law;* William M Wiecek, *The Lost World of Classical Legal Thought: Law and Ideology in America, 1886-1937* (New York:Oxford University Press, 1998).

Chapter 6

Ceilings: The New York Investigations of Corporate Abuse

The American states gradually, and then more rapidly, transformed their corporation law. Pressures inducing them to do so were competitiveness of their individual political economies and the pressures towards charter liberalization as a result of state competition in a federal system. Yet states also resisted a complete capitulation, and sought to restrain some corporate activities. The states were not simply tools of the business class; they sought to maintain their own authority to regulate their political economies. This led to conflict with some business interests that sought to push beyond the limits that the states sought to impose.

To understand the dynamics of political economic development requires that we address this conflict. How did corporations respond when states sought to impose ceilings on their behavior? What tools did the states have to impose limits, and how did corporations seek to evade or otherwise circumvent the limits that would tend to hamper their business plans? This chapter begins to address these questions by an examination of antitrust investigations in the state of New York, from 1888 to 1897.

To date there have been anecdotal descriptions of episodes when corporations encountered ceilings. One example is the creative use of special legislative charters. In the late 1860's the Pennsylvania legislature routinely issued special charter with special privileges to speculators that held them in their pockets.[1] John D. Rockefeller

[1] Pennsylvania, Constitutional Convention (1872-1872), *Debates of the Convention to Amend the*

purchased one such charter in 1871 that permitted corporations to hold stock in companies outside of the state. He used this to vehicle to consolidate oil pipelines.[2]

The formation of the trusts was an effort to evade state restrictions. A trust is a combination of corporations that have sold all of their shares to a central trust office, in order to evade state restrictions on mergers and holdings. The central trust organization was not incorporated itself, but the constituent companies usually were. Thus it amounted to a partnership of the constituent corporations.[3] Standard Oil formed the first trust in 1882 to coordinate production output and price; six other trusts copied this strategy during that decade.[4] The Cotton Oil Trust, which operated in Louisiana, was prosecuted by that state on the basis that it had no legal standing. When prosecuted by the state, officers dissolved the company and incorporated it it in Rhode Island (and then later New Jersey), and then informed Louisiana state prosecutors that the firm they were prosecuting no longer existed.[5]

The successful prosecution of the North River Refineries Company in New York in 1888 highlighted the difficulties faced by state legislators in regulating their creations in the new national market. The North River Sugar Refineries was a New York company that sold out to the newly formed Sugar Trust. New York prosecuted the company for violating its charter when it jointed the Sugar Trust (they asserted it

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Constitution of Pennsylvania: Convened at Harrisburg, November 12, 1872, Adjourned November 27, to Meet at Philadelphia, January 7, 1873... , 9 vols. (Harrisburg: B. Singerly, 1873), v. 4, 581-3.

2 Alfred D. Chandler, Jr, *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, MA: Belknap Press., 1977), 323.

3 Ibid., 319.

4 Ibid., 321-.

5 For a narrative, see William G. Roy, *Socializing Capital: The Rise of the Large Corporation in America* (Princeton, NJ: Princeton University Press., 1997), 199-203.

had no power to do so.) As a result of the successful prosecution, the Sugar Trust incorporated itself as a New Jersey holding company. The E.C. Knight Company was a subsidiary of the newly formed American Sugar Refineries Company. E.C. Knight was prosecuted by the Cleveland Administration under the Sherman Act, but the merger of these different companies was upheld in the *E.C. Knight* (1895) decision.[6] There the Supreme Court ruled that manufacturing was distinct from commerce, that the commerce clause of the United States Constitution authorized congressional regulation of the latter but not the former, that the American Sugar Refining was a manufacturer, and that therefore the U.S. Government did not have authority to regulate it.

Despite these episodic narratives, we lack a systematic account of corporate action in the face of state limits, as well as state efforts to restrain corporations that sought to push through the ceilings. This examination of the New York State Legislature's efforts to investigate trusts contributes to this task.[7] It also contributes to our understanding of how legislators viewed the role of the state in regulating corporations. It may be no coincidence that provisions discussed by delegates at the state constitutional conventions did not directly address corporate mergers. Most of the convention, after all, preceded the merger movement of the late 1890's. In the investigations that took place in New York from 1888 to 1897, by contrast, there was no more pressing issue.

[6] *United States v. E.C. Knight & Co.* 156 U.S. 1 (1895). See Roy, *Socializing Capital*, 207-213.

[7] Examination of *Ultra Vires* cases (those where a corporation is prosecuted for acting beyond its charter) is another method of such investigation.

Legislators were forced to confront the same issues that led to a crisis of legal orthodoxy at the bar and bench. Like the judiciary, legislators had to address pressures of economic competitors seeking sanction for their favored abstract property rights. The reactions of the legislators would be different from those of the judiciary for at least three reasons. First, under an orthodox conception of law legislatures make law while courts interpret law. The pretense of impartiality while legislating preferences from the bench was not an issue. Second, the outcomes decided by legislators need not pretend to be logically consistent. Rather, votes counted as much, if not more, than persuasion. Third, while courts address legal facts prevalent in disputed cases, legislators have the opportunity to consider more broadly relevant social facts.[8] The broad concern over social facts was evident in the New York investigations.

Elements constituting the crisis of orthodoxy in the New York Legislature involved the failure of competition in the face of monopoly, the relationship between principle and agent, the setting of boundaries between public and private spheres, and the valuation of new intangible assets. Corporations controlled their books, and states had problems getting information from them. The innovation of Moody in evaluating the financial condition of corporations was not yet established (although Moody was already advocating this). Thus investors were often blind to inner corporate workings. The states were similarly nearly powerless in gathering information, despite their avowed right to inspect corporate books. As a result, they were also nearly powerless in crafting legislation to control the corporation. In the new industrialized world, with

[8] Donald L. Horowitz, *The Courts and Social Policy* (Washington, D.C.: Brookings Institution, 1977).

a national market, the states had largely lost control of their creation, and had thus also lost the control over their local political economies.

The New York Investigations of Trusts

New York investigated trusts on five occasions from 1888 to 1897.[9] During the investigations the legislature had to mediate popular demands to restrain the concentration of economic power with corporate pressure to permit combinations. In these investigations the legislative committees subpoenaed and questioned witnesses with full stenographic recording of the proceedings.[10] The timing of these investigations is fortuitous. The first two occurred in 1888 and 1889, after the creation of the Standard Oil Trust in 1882. The 1888 investigation occurs before New Jersey's law sanctioning the Cotton Oil consolidation, and the 1889 investigation occurs before New Jersey more generally liberalized its law later that year. The next investigations occur in 1891 in response to the horizontal consolidation of the Sugar Trust that year, and in 1893 in the aftermath of a coal monopoly. These happen after the passage of the Sherman Antitrust Act, but before the decision of *E.C. Knight* in 1895[11] which limited its application. They were also clearly limited by the small amount of time given to them to conduct hearings and report back to the full Senate. The 1891 investigation sought to remedy this weakness via focus on the Sugar Trust only, with

9 The Senate also investigated the coal monopoly in 1893, which I do not address in this paper. New York (State), Legislature, Senate, *Testimony taken before the Special Senate Committee Relative to the Coal Monopoly* (Albany: J.B. Lyon, 1893).

10 This is fortuitous because of the paucity of good records in New York. New York's library burned down in 1912; many documents were destroyed. New York did not establish an archive until the 1970's.

11 156 U.S. 1 (1895).

the intent of generalizing its findings to other industries. The final investigation was a high profile effort in 1897, after the *Knight* decision that gave horizontally integrated companies had gained the imprimatur of the Supreme Court. The 1897 investigation was arguably the most successful of the investigations in shedding light on practices of industry, yet by this time many large corporations had already achieved national dominance via horizontal merger.

Market Consolidation and Legislative Dilemma

In order to address the issues that arose in the trust investigations it is necessary to discuss some basic elements of economic theory that drove business strategies. It was, after all, these strategies that concerned legislators. Under idealized conditions of perfect competition, with unlimited entry of competitors, companies will not make a profit. If identical substitutes for a good can be provided by a limitless supply of competitors, the profit margin in the long run will tend towards zero.[12] Actors at the time understood this. Under conditions of high fixed costs, companies will be induced to sell below long-term costs. Companies thus sought ways to preserve their pricing power, which essentially reduced the firm's price elasticity of demand. They pursued a wide variety of strategies to do so.

One method of preserving pricing power was product differentiation.[13] This strategy involved selling high quality goods, often branded. These could sometimes be

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12 James K. Galbraith and William J. Darity, Jr. *Macroeconomics* (Boston: Houghton Mifflin, 1994).

13 Naomi Lamoreaux, *The Great Merger Movement in American Business, 1895-1900* (New York: Cambridge University Press, 1985), 16-18.

reinforced with patents and trademarks. Another strategy was mass production of marginally differentiated products at a low cost. To pursue this strategy required erecting barriers to entry.[14] An firm with a dominant market share could limit competition on price as long as it maintained the lowest cost of production. Under these conditions it could then act as dominant firm, setting the price and forcing competitors to follow. So long as the firm remained the lowest cost producer it retained the power to discipline rivals that might otherwise be tempted to cut prices in order to boost output. The dominant firm will do so by engaging in a price war that will severely harm the less efficient rival firms.

Another strategy was collusion or combination. In the 1870's and 1880's this involved cartels that set target prices and divided the market share among the participants. At the time cartels were not illegal, but they were also not legally enforceable in courts of law. With artificially high prices, participants had an incentive to overproduce. As a result most cartels failed in short order. In order to control price and output a way had to be found to legally bind the disparate parties. To accomplish this, the trust device was introduced in 1882 by New York lawyer A.C. Dodd. He designed it to consolidate the oil industry under the control of John D. Rockefeller.[15] The trust combined a number of (usually) incorporated companies as a "partnership" of companies (again, the trust itself was not incorporated.) Each constituent firm was run separately, but with decisions on pricing and output made at

[14] Ibid., 27-37, 160-1.

[15] Rachel Rudmose Parker, *The Subnational State and Economic Organization: State Level Variation in Incorporation Law in the United States, 1880-1904* (Ph.D. Dissertation, University of California, Los Angeles., 1993), 30

the central office. Profits of each unit were funneled to the central trust, and then were distributed on a percentage basis to each of the members of that trust. By the end of that decade, its use had spread to cottonseed oil, sugar, and elsewhere. The Sherman Act outlawed the trust, although the phrase “antitrust” remains with us, usually referring to monopoly or oligopoly.

Factor and rebate agreements were more successful at reducing competition. A jobber, wholesaler, or factor that wished to trade specified goods was required to sign a contract with terms that set a minimum allowable price for selling the manufacturer’s goods. Often they would be excluded from selling similar goods manufactured by competitors below the set price (and in some cases, from selling competitors goods at all.) Those who met these terms would receive a rebate of perhaps ten percent, and this was often the distributor’s entire profit on the items. In practical terms, those who did not abide by the agreement could not survive in the trade. Because the rebate was given after the sale, the manufacturer had a means of enforcement. Some goods, such as sugar, were of such importance that if the wholesaler did not carry it they would not be able to survive; retailers required these goods. Legislators had to consider the propriety of these practices, and sought levers to control the abuses.

The Natural Law of Supply and Demand

For members of the legislature of New York the “natural” law of supply and demand was the foundation of accepted economic theory. Yet there were disputes over the nature of markets, and no generally accepted understanding of market failure.

The joint committee report of 1897 addressed the issue directly:

> "it is a situation which seems to be the natural evolution growing out of the fierce contest for supremacy in the fields of commerce and finding a reflection in almost every department of human activity. That it is a natural evolution seems clear from the fact that it is the universal concomitant of progress, marking in fact, to a very large extent, the progressive stages of commercial development created by the natural impulse toward better conditions, and in its turn creating that complex system upon the proper adjustment of which the welfare, comfort and prosperity of the people so largely depend."[16]

The report argued that just collections of capital move "with the natural law", while unjust trusts and combinations "operate against the natural law."[17] Defining exactly what this meant in practice would be the legislature's charge, and would be contested throughout.

The process of Schumpeter's creative destruction was well understood by contemporaries, even if economists had yet to synthesize the phenomenon into a coherent theory.[18] The 1889 committee report stated

> [t]he aid of laws for the prevention of trusts is usually invoked to protect the weak individual against the strong combination, and yet every day in the world of commerce the weak individual is overcome by his strong competitor, who had more money, better credit, or other greater advantages than he. In a world of nature everywhere this rule prevails—the weak are overcome by the strong, and nothing lives or thrives but at the expense of something else which was in some measure its competitor.[19]

Creative destruction was often in fact predatory destruction. This included

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16 New York (State), *Report and Proceedings of the Joint Committee of the Senate and Assembly Appointed to Investigate Trusts* (Albany: Wynkook Hallonbeck Crawford, 1897), 8. Hereafter referred to as "New York (State), *Report and Proceedings* (1897)."

17 Ibid., 10.

18 Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle* (New York: Oxford University Press 1961[first published 1911]).

19 New York (State), Legislature, Senate, *Report of the Senate Committee on General Laws Relative to Combinations Commonly Known as Trusts* [Document 64] (Albany: Troy Press, 1889), 5. Hereafter referred to as "New York (State), *Report of the Senate Committee* (1889)."

factor and rebating agreements that effectively shut out a wholesaler or jobber who refused to abide by the proffered arrangements. In this case a wholesaler who sold a competitor's brand at lesser price could be shut out, and their business effectively ruined. In 1896 the Arbuckles company decided to offer packets of sugar with their coffee distribution. American Sugar Refineries Company threatened them, then purchased a rival coffee distributor and underbid Arbuckles on price.[20] Farmers who tried to circumvent the Milk Exchange were overtly threatened with ruin.[21] Such competition was ruthless, and raised the question of whether such behavior merely reflected healthy competition, or whether it reflected the abuse of monopoly or oligopoly.

The perils of interfering with the market were made apparent in the 1889 investigation. In 1888 the legislature mandated a (lower) rate for unloading grain to elevators in Buffalo. Before passage elevator operators had included five days free storage with the charge for unloading. After passage the grain elevators formed an agreement whereby they automatically charged for the first ten days automatically. The result was to make the bill a "dead letter;"[22] most witnesses felt the bill was counterproductive at best. A boat operator, for whom the bill was designed to benefit, claimed that the bill "is legislating no money into the boatman's pocket."[23] The market seemed to defy legislative interference.

Market imperfections were recognized in the identification of individual

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[20] New York (State), *Report and Proceedings* (1897), 145-8.
[21] New York (State), *Report of the Senate Committee* (1889), 163.
[22] Ibid., 100.
[23] Ibid., 105.

problems, but not as a theoretic construct that would supply a rationale for systematic government supervision of markets. Nevertheless, the members of the legislature confronted behavior that seemed to contradict the natural law of supply and demand. Members of the state Senate felt the need to consider the regulation of industries dominated by monopoly.

Monopoly & Price Fixing

Price fixing was a central concern of all investigating committees. Firms combined, bought out competitors, and raised prices. The difficulty from a theoretical perspective was distinguishing the right to contract with the abuse of economic position. That two individuals could agree to join forces was recognized as perfectly legitimate. The difficulty came when companies with high fixed costs made contracts to join forces and monopolize markets. In that case the law of supply and demand would be “repealed.” Determining where to draw the line was the dilemma the legislature faced. In theory the state had leverage over incorporated business to the extent that those businesses required state permission to combine.

The 1888 investigation was the first, and as a result in some ways the most interesting. Henry O. Havemeyer was chairman of the Sugar Trust. He claimed that each plant in the trust was run as a separate entity, and that members of the trust did in fact compete with one another on price of raw material and for the best price on the finished product. Better managers received “moral credit” in comparison with managers at sister plants.[24] The same was claimed by the John Scott of the Cotton Oil Trust:

> It is not function of the trust to control the operations of the refineries, and they do not control the operations of the refineries; the refineries are separate and distinct corporations, with a president, vice president, board of directors, and set of officers; and they manage their own businesses.[25]

This claim was not made in later years. By 1889 the Havemeyers and other witness were increasingly likely to evade questions. Havemeyer and others obfuscated how the board of the trust controlled member plants, essentially denying that there was centralized control. They claimed to have no record as to how the constituent companies that went into the trust were valued before combining, even despite the fact that closed plants shared in profits. Much of this information would not be exposed until the 1891, and especially 1897 investigations.

The 1889 committee report noted that ancient activities of forestalling, regrating, and engrossing were originally misdemeanors in common law.[26] Although the legislature saw these laws as anachronistic, members struggled with determining what sorts of anti-competitive behavior were against "natural laws." Appleton Sturgis was part of a "loose" combination of seeking to control the distribution of cotton

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[24] New York (State), Legislature, Senate. *Report of the Senate Committee on General Laws on Investigation Relative to Trusts* (Document 50; New York: State Printer March 6, 1888), p57. Hereafter referred to as "New York (State), *Report of the Senate Committee* (1888)."

[25] New York (State), *Report of the Senate Committee* (1889), 241.

[26] The 1889 report described these as follows: "*Forestalling* the market was declared by statute to be "the buying or contracting for any merchandize or victual coming in the way to market or dissuading persons from bringing their goods or provisions there, or persuading them to enhance price when there, which practices make the market dearer to the fair trader." *Regrating* is described by the same stature to be "the buying of corn or other dead victual in any market and selling it again in the same market or within four miles thereof." *Engrossing* was "the getting into one's possession or buying up large quantities of corn or other victuals with intent to sell them again."" New York (State), *Report of the Senate Committee* (1889), 7.

bagging. When his organization was referred to as a trust, he protested that "[t]here is no trust about it; it is simply a corner."[27] Before passage of the Sherman Act the attempt to corner a market was, if not perfectly legitimate, at least perfectly legal.

Industrialists often made references to the need for reasonable profits. The sugar combination claimed its intended purpose was to prevent prices "from being lowered to a disastrous extent."[28] Perhaps the bluntest statement was by Franklin Woodruff, a grain elevator operator. He said of competition: "[w]e want to destroy it all we can; competition is a bad thing." He was not alone in this sentiment.

Investigators were concerned that the consumer was hurt when prices rose as a result of combination. The 1897 joint committee found that while prices might be more stable than before combination, the price level was higher than previously. The industrialists consistently denied this. Charles Flint of United States Rubber Company justified the merger on account efficiencies from centralization and economies of scale. Flint claimed that they "are enabled to compete with the pauper labor of the densely populated countries, owing to the fact that they use labor saving machinery."[29] Nevertheless, even when U.S. Rubber had excess capacity it bought up competitors and proceeded to shut them down.[30] Other combinations followed similar strategies.

The Principle-Agent Problem

In the investigations of 1888, 1889, and 1891, corporate officers often claimed

[27] Ibid., 66.
[28] New York (State), *Report of the Senate Committee* (1888), 60.
[29] New York (State), *Report and Proceedings* (1897), 532.
[30] Ibid., 521.

to not have the authority to release information. Legislators sought to pierce the veil of secrecy that witness sought to create. John D. Rockefeller of the Standard Oil Trust claimed in 1888 that the trust agreement was between individual shareholders, not corporations.[31] Thus he argued that the information was not his to divulge. He also refused to hand over minutes of trustee meetings, and did not disclose the existence of a proxy book with details on certificate distributions.[32] Under pressure from the 1891 investigative committee, Theodore Havemeyer of the Sugar Trust claimed that despite being a senior officer he had no power to gather documents of the constituent members of the trust, or even from the consolidated American Sugar Refineries Company.[33]

Rebating and factor agreements were used by a great variety of industries. Rebating contracts were fixed the price of goods, sometimes stipulating that no competitor's prices would be sold at all, or at least that the competitor's goods could not be sold at a lower price. The wholesaler or retailer would be guaranteed a rebate as long as the conditions of the contract were met. The result was to prevent competition on price. This also meant that the established company, familiar to the public, would have an inherent advantage over any upstart competitor. Manufacturers blamed the wholesalers for instigating rebating contracts, while the grocery wholesalers claimed credit for the agreements. Both defended the practice.

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[31] New York (State), *Report of the Senate Committee* (1888), 442.
[32] Ibid., 577.
[33] New York (State), Legislature, Senate, *Report of the Committee on General Laws Relative to Trusts and Sugar Trusts* (Albany: 1891), 705-6. Hereafter referred to as "New York (State), *Report of the Committee* (1991)."

The 1897 committee report viewed factor agreements as fictional consignments. These agreements ostensibly treated the factor as an independent operator, while at the same time controlling his actions. The rebate was the only profit allocated to the consignee. The committee saw this as a means to control prices, and it the Sherman Act appears to have had little impact on the practice. The use of factors was a way to try to avoid charges of monopoly while still maintaining price control.[34] The voluntary control over the factors pushed prior limits of the principle-agent relationship.

The Public/Private Distinction

Legislators occasionally demanded that a given corporation open its books by invoking the fact that the state had granted the corporation its charter. That had indeed been the purpose when writing the statutes, but in these investigations the legislators had at best limited success. When asked in 1891 if "this partnership of stockholders, whose interests aggregated to $50,000,000, carried on business two years and did not keep any record of their proceedings," John Searles, treasurer of the Sugar Trust replied: "they kept no formal record."[35] Records were not required to be kept, were claimed not to exist, and were moved to undisclosed locations. Even when witnesses acknowledged corporate books to have existed, they often claimed not to know where they were.

John Parsons of the Sugar Trust argued in 1888 that the state had no right to

34 New York (State), *Report and Proceedings* (1897), 22-28.
35 New York (State), *Report of the Committee* (1991), 680.

delve into private business matters.[36] He and other officers of the Sugar Trust took pains to obfuscate the manner in which the different "independent" members of the trust combined together. Envelope manufacturer John Q. Preble objected to divulging information about payments from his individual firm to the envelope trust. As a Massachusetts corporation he felt the New York legislature had no authority to examine these details of his operations, even though he did business in New York.[37] The wholesale grocers simply claimed they did not collude, as did virtually every other combination called before the committee that year. The conflict over these boundaries would persist through the 1897 investigation.

Much investigative time was devoted to determining what books were maintained and where they were kept. Elihu Root acted as a general counsel for a variety of witnesses in the 1888 and 1891 investigations, and also for the Sugar Trust in the 1891 investigation. He repeatedly claimed that information that the committee wanted to see was private, and did not have to be given to the committee. For example, in trying to limit the books the committee would see stated that "[t]he trouble is in separating the matters as to which you have no more right to inquire than any other number of private gentlemen have from the matters as to which it is your duty to inquire in the public interest. It is very difficult to separate the two things, and if you lump a lot of things in, they will come together."[38] Further questioning requesting three sets of records is illustrative:

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36 New York (State), *Report of the Senate Committee* (1888), 19.
37 Ibid., 332-3.
38 New York (State), *Report of the Committee* (1991), 695.

> Mr. Root.—I submit to the committee that the last two of these are wholly beyond the province of this committee. It is not part of the duty nor within the power of the Senate of this State to inquire into the question whether the stockholders of a corporation or the certificate holders of a trust may be having all the profits or the property to which they are entitled properly dealt with or properly accounted for. That is a question for which our judicial system is established, and the courts are open to all persons to assert and defend their private rights in accordance with the established procedure of judicial tribunals; and to undertake to assert the right of the certificate holders, or to inquire in the duties of them, on the part of the Senate, would be a usurpation totally foreign to its duties.
>
> Senator Erwin.—Would it if it were a fraud?
>
> Mr. Root.—I think it would.
>
> Senator Coggeshall.—That is a corporation doing business under the laws of the State. Do you say they should have no right to investigate as to the rights of certificate holders or stockholders?
>
> Mr. Root.—I say this, you have no to right to it; absolutely none.....
>
> Senator Erwin.—I, myself, have supposed that we had the right to have these books, and to examine them to show whether you made your profits or not; because the public are the people who have bought your stock, and the stock that you had, and that you have given to the public; and if it was wind, and was not paid for, this committee have the right to know whether it is a fraud or not.[39]

The legislature was moderately more successful at opening up stock company books in 1897, using what leverage they had to extract information. The United States Rubber Company tried to assert that capitalization information was private. Committee chairman Clarence Lexow stated: "we regard this question of capitalization as one of the important questions of this investigation, and whether your company be a New Jersey corporation or a New York corporation you do business here and your system affects the economic condition of our State, and we are entitled as a legislative committee to know it."[40] The use of the charter as leverage would continue after the

[39] Ibid., 699-700.
[40] New York (State), *Report and Proceedings* (1897), 493.

investigation. New York Governor Benjamin B. Odell in 1901 justified the taxation of corporations on the basis of special rights gained: “corporations receive from the State certain rights,” and thus “should pay a tribute…for that which they have received.”[41] Nevertheless, the state was ineffective in procuring information it felt it had a right to get, and threating to revoke the charter was becoming an increasingly ineffective weapon in gathering the same.

Intangible Property

Values place on capitalization and the watering of stock were pervasive concerns of the investigative committees in all years. Legislators were concerned that the public being offered the stock was being deceived and fleeced by overvalued stock. Witness in all investigations tried to avoid revealing how individual and consolidated manufacturing companies were valued. None of the members of the Sugar Trust claimed to be able to locate or recall details of papers that would explain how the constituent companies were valued. Charles Flint of United States Rubber (formed in 1892) was asked about $26 million in stock issued by 1893, but could not explain how much was distributed to each of the constituent companies that were bought up.[42]

Various practices raised the suspicions of the investigators. John Searles acquired assets of $350,000 and that same day sold them for double that amount, minus fifteen percent. The entities formed into the American Sugar Refineries

[41] Quoted in Richard L. McCormick, *Shaping Republican Strategy: Political Change in New York State, 1893-1910* (Yale University, Ph.D. Dissertation, 1976), 367.
[42] New York (State), *Report and Proceedings* (1897), 478.

Company were separately valued at around $7 million, but then issued stock amounting to around $50 million.[43] In the investigations of 1888, 1889, and 1891 officers of the Sugar Trust stonewalled, for the most part successfully. In 1897, after *E.C. Knight*, the committee was slightly more successful in getting these documents. By then American Sugar had the imprimatur of the U.S. Supreme Court for its existence. Legislators also struggled (unsuccessfully) to distinguish "speculation" from "legitimate" stock market investment. The acceptance of market based prices for intangible assets is a staple of 20th century economic practice, was still gaining acceptance. Many still thought it immoral.

Charles Flint of the United States Rubber Company made a better answer to the question of stock watering. Flint asserted that the value of a company could be far greater that the amount of capital stock that the company held.[44] Rather, the valuations of the constituent companies were made with a view towards "future earning capacity."[45] The justification was in part that profits were piled back into the business. Flint also explicitly explained the value of stock certificates circulated by the trust not only relegated to plant and other hard assets, but also "the value of patents, trade-marks and business franchises."[46] More to the point, however, Flint asserted that "$20,160,000 of stock was issued exclusively for what is called "good will.""[47]

Flint also noted that "In the rubber business the value of the trade-mark is one

[43] Ibid., 384.
[44] Ibid., 463.
[45] Ibid., 461.
[46] Ibid., 460.
[47] Ibid., 467.

of the principal items of value."[48] This was capitalized by the issuing of stock. When asked to explain this further, he explained:

> I mean to say that in this business the consumer is dependent upon the trade-mark; the trade-mark represents the integrity of the manufacturer, or it represents the reverse; the successful manufacturers—those manufacturers that have stood the test of time over the forty years down to the present day, have made honest goods for a period of fifty years... I will say this: During the past, say five years prior to the organization of the United States Rubber Company the greater part of the capital which was used in an endeavor to establish new trade-marks was lost.[49]

The best answer to the question of valuation came from Henry Burn, of the National Wall Paper Company. Burn stated that common stock was issued for good will, patents and trademarks. To arrive at a figure Burn stated that "we calculated the value of a business by its earning capacity; we multiplied the net profits of a certain year by 16 and that became the total issue of stock to the concern for its business; from that total we deducted an amount for tangible assets; from that we issued debenture stock and for the balance we issued common stock."[50] The company consolidated its market, bought out competitors, insuring a profit. It then issued stock calculating a 6 percent annual return, with a multiple of 16. "Good will" was the difference between tangible assets and the value of the earnings. Thus was the concept of a price-earnings ratio introduced into the debate over what had been considered stock watering. Obviously the original organizers, if successful, could make huge sums of money by selling stock to outsiders after the consolidation. "Good will" was a familiar concept, but its capitalization appears to have been a novelty; it was introduced as an

48 Ibid., 459.
49 Ibid., 534.
50 Ibid., 681.

explanation of stock values only in the 1897 investigation. Legislators at the time remained skeptical: to them it was all watered stock. Practice in the 20th century, of course, would ratify the new market valuation of intangible assets.

Investigative Impact and the Incapacity of the State

The legislature of the State of New York had the task of legislating in the face of changes in the practice of industry. The industries they sought to regulate were those that affected the public in their state. These industries adopted practices that would push the limits of prior understandings of the appropriate boundary between private contract and "unnatural" combinations, the nature and value of intangible property, and the relation between principle and agent. It sought to combat this in part with subpoena of documents that were considered private, subjecting corporate practices to some minimal level of public oversight. The agenda placed before the state was determined in part by the types and structure of industry in the state.

The companies being investigated were more inventive than the legislature's ability to create institutional structures to regulate them. The various legislative committees were largely ineffective in their attempts to delve into the details of individual businesses. All investigative committees met for short periods of time, never more than three weeks. They were temporary committees, dissolved after the reports were filed. The 1888 committee report decried this problem, but the 1889 repeated the same procedure. The 1891 investigation attempted to remedy these inadequacies by holding hearings focused solely on the Sugar Trust, with the overt intention of applying its findings to the trust problem in general. It nevertheless failed to open the books of the trust, or to determine how the capital stock constituent corporations was calculated.[51] The 1897 investigation was more aggressive, but this report too complained about the inadequate resources devoted to a problem of such magnitude. The institutional mechanisms were inadequate to the challenge.

The remedies recommended were limited. The 1889 committee report noted a judgment against the North River Sugar Refining Company from earlier in the year. It expected that "these questions are safely in the hand of judicial tribunals," and recommended no legislation.[52] The 1891 committee report suggested legislation that would, first, either prevent the formation of trusts or create a supervisory board; second, require corporations chartered outside the state to pay a tax for the privilege of doing business in the state; and third, require corporations doing business in the state to keep books within the state, subject to inspection by the Attorney General.[53]

The 1897 Joint Committee report argued that the state should refrain from engaging in a "race to the bottom" by liberalizing its law:

> We do not believe that the State of New York, for the mere purpose of securing colorable incorporations here and receiving annually a pittance for permission to avoid those reasonable and salutary requirements which our laws impose, should alter its system so as to meet the competition of any other State for this kind of corporate organization. We cannot afford to offer our corporate charters to be trafficked in by those who refuse to submit to reasonable restraints and search the land over for the most complacent jurisdiction which holds its corporate franchises so cheaply that they may be had for the asking on the payment of a trifling tax by those who shun regulations devised to

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51 New York (State), *Report of the Committee* (1991), 4-7, 11-12.
52 New York (State), *Report of the Senate Committee* (1889), 14.
53 New York (State), *Report of the Committee* (1991), 11-12.

> secure honesty of management, resent visitorial powers exercised by the State for the benefit of the people, and avoid provisions designed for the safety of the investing public and the security of creditors.[54]

The legislature passed laws that abolished combinations for the purpose of monopoly, and required corporations to keep books in the state and file annual reports with the Secretary of State. How monopoly combinations would be distinguished from other combinations was not defined.[55]

Conclusion

The investigations evince a common pattern: the non-political world is agile and changes continuously, while the political world is more reactive and changes only slowly, until pressures build up and force a jump shift in political organization.[56] Self-seeking entrepreneurs created markets, facilitated by property rights granted by the state. The state had limited capacity to examine corporate documents, items that today would be public. It conducted hearings, but did not have a regulatory agency to monitor and adjust to changing circumstances. Regulatory agencies did exist for railroads and coal, which were considered "public" utilities.

The state was powerless to prevent companies from taking charters in New Jersey. Witnesses admitted to being drawn by the low taxes in New Jersey, but generally denied New York's laws were inferior. While there were hostile questions

[54] New York (State), *Report and Proceedings* (1897), 22.
[55] New York (State), *Report and Proceedings* (1897), 54-59.
[56] The theoretical import of the comparatively static development of the American state in relation to developments in the political economy is developed by Walter Dean Burnham, *Critical Elections and the Mainsprings of American Politics* (New York: Norton, 1970).

asked of company officers about their taking out New Jersey charters, no sanctions were contemplated. Without the ability to credibly impose a sanction, the authority of the state over the corporate creation was limited. Corporations required the state to exist, and received their rights and obligations due to state law, but in a practical sense they were no longer answerable to the state.

The growing acknowledgment of intangible property is evident in the record, even as it troubled many minds. The 1897 committee report concluded "[t]here could not be prosperity without confidence that "every person, natural or artificial, shall have the enduring protection of just and equal laws."[57] Of course a corporation itself is intangible and incorporeal, but legislators had dealt with corporations for decades. The legal devices of corporate capitalism had to be accepted as well. Such were corporate shares, traded impersonally and subject to the vagaries of market fluctuation. Such also were copyrights, patents, and trademarks. Perhaps most controversially, such was the case with the capitalization of corporate "good will." It is of no small significance that its advocates were the lawyers of the businessmen.

[57] New York (State), *Report and Proceedings* (1897), 12. This reference was made the same year Ernst Freund introduced the idea of the corporation as a "natural" (Horwitz 1992, 71).

Chapter 7

Conclusion: A New Political Economy

States in the nineteenth century sought to regulate their political economies via statutory corporation law. In doing so they created the situations which gave rise to the large industrial corporation. State statutory practice was an essential component of the historical context and material conditions that led to advent of corporate capitalism. Thus the new form of the industrial corporation was a constituent part of a new economic system situated at the leading edge of economic development. The outburst of entrepreneurial energies that became corporate capitalism was predicated on changes in state law.

The law is an essential element of the conditions necessary for development. It arises out of practices in given institutional settings, with given institutional dynamics. The American innovation of corporation law that supplanted the British system as the dominant form of corporate organization in the world was built within the context of federalism.

States crafted their laws to suit the political imperatives of the state's economic topography. These imperatives were slightly different for each state. Nevertheless, states large numbers of small producers were more likely to resist liberalization that tended to allow large size. In this regard, a system of federalism was crucial in the development of liberalized corporation law. States experimented with provisions to improve their local economies, but were not in a position to resist impositions of their sister states. The Supreme Court acted as the last bastion of defense against overly aggressive state localism that might tend to inhibit building a national market.

The rise of corporate capitalism in the early twentieth century was built upon innovations of the nineteenth century. The New Jersey laws ought not be characterized as a “big bang” that accommodated the interests of corporate lawyers. Rather, they should be characterized as an inflection point on a trajectory that was well in motion. This observation has great significance for political economic theories of economic development. It is indicative of a deeply ingrained practice of enabling corporate development. Despite Lincoln Steffens' protests to the contrary, it was a standard process for states to adjust and liberalize their corporation law.[1] The New Jersey innovations were less radical than Steffens thought; many states had been relaxing their corporation law over the course of the century.

The consequences of statutory laws may well not have been anticipated by those who crafted them. States that broadened their general laws may not have recognized that they were setting precedents for laws that would permit a corporation to engage in any activity. States that passed general laws appear not to have considered that the advance of general laws would generate a crisis over the nature of the corporation among academic legal theorists. It is unlikely that the Supreme Court ruling in *E.C. Knight*, which sought to protect states' regulatory authority, had been anticipated by them. Just as important, it is unlikely that states intended to weaken their own capacity to regulate their economies when they liberalized their laws to

1 See Lincoln Steffens, “New Jersey: The Traitor State,” 25 *McClure's*, 41-55 (1905).

allow corporations wider leeway to engage in economic activities. Nevertheless, state practice created the historical conditions under which the great constitutional debates over the relation of the state to the corporate political economy took place.

State legislators were acting in a setting where economic conditions were changing rapidly. Old conceptions of property gave way to a new economic reality. Legislators faced the same pressures on orthodox modes of thought that led to a crisis in doctrine at the bench and among legal academics. However, the impact on the states was different than on the judiciary. The price for the states was not the accommodation of a new set of property relations to judge legal decisions. Rather, the prices for the states was a decline in their ability to regulate their political economies in the face of a new national market.

There was a qualitative difference between state regulation in the nineteenth century and federal regulation in the twentieth. Federal regulatory policy was built upon the politics of antitrust. The states still gave the corporation its attributes; the federal government, as a limited government of assigned powers, was still limited in its capacity to grant charters. Theodore Roosevelt in 1908 maneuvered to have a federal law of incorporation proposed in Congress. The Hepburn Bill of 1908 crashed upon conflicting views of legitimate federal action. So did Roosevelt's more radical proposals for strong administrative corporate regulation made during the election of 1912. Federal regulation took place via the courts in the Taft administration, and via the regulatory action of the Clayton Act and the Federal Trade Commission Act during the early Wilson Administration.[2] These federal actions took place after a corporation was granted attributes in the states. Federal regulation thus proceeded the leverage of statutory law, the stronger of these two regulatory traditions.

The evolution of business corporation law adds to our understanding of the development of American politics. Burnham argues that the election of 1896 was about the success of the metropole over the periphery.[3] A great turning point in American political history, it portended a transition away from a predominantly agricultural society. It also signaled the decline of true participatory democracy, and the rise of oligarchic rule. The politics of this transformation cannot be properly understood without an appreciation of the transformation of the political economy, something for which Burnham is acutely aware. The decline in state capacities to regulate their economies provides a crucial element of the context of national political change.

In this regard there is great irony. Richard Bensel argues that there were three major political economic policy areas that confronted the political parties and the national government in the late 19th century. These were the gold standard, the tariff, and building a national market. He suggests that building a national market was the most essential of these three areas. The responsibility for protecting this policy came to reside in the Supreme Court, the branch of the government most insulated from

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2 Martin J. Sklar, *The Corporate Reconstruction of American Capitalism, 1890-1916* (New York: Cambridge University Press, 1988).

3 Walter Dean Burnham, "The Changing Shape of the American Political Universe," 59 American Political Science Review, 7-28 (1965).

political pressures.[4]

There was another element to the policy of building a national market, and this was the state-based law of corporations. These powers were constitutive, in that they enabled corporate existence and defined its attributes. The great irony is that state legislatures are the government institutions that are the least insulated from public pressures. In this regard it is crucial to note that activity to untether the corporation from restrictive state statutes occurred in far more locales than merely New Jersey: innovations were made in many of the states. This is an strong indication that the liberalization of statutory corporation law was not merely the fault of a corrupt legislative process, as was charged by Lincoln Steffens in 1905. It was, rather, a process deeply ingrained in the practice of state legislation. There is no question that at crucial moments the Supreme Court did come to support national market building by protecting against state policies that sought to discriminate against foreign corporations. But nevertheless, the constitutive structure of corporation law developed in the states. This was a necessary element in the building of the national market.

Skowronek contends that building national administrative capabilities as a response to industrialization involved more than mere creating a more efficient state. Rather, he argues, it involved creating a qualitatively different state.[5] The struggle to shape a new national state apparatus had to contend not only an entrenched laissez faire ideology, but also a well entrenched Supreme Court that saw itself as the

4 Richard Franklin Bensel, *The Political Economy of American Industrialization, 1877-1900* (New York: Cambridge University Press, 2000).

5 Steven Skowronek, *Building a New American State: The Expansion of National Administrative Capabilities, 1877-1920* (New York: Cambridge University Press, 1982), 4.

protector against national administrative capabilities. In addition, the struggle over building national state capacities in economic regulation, at least, was conducted on the shoulders of shattered capacities of the several states. The policy of Theodore Roosevelt of regulating corporate action via state structures is made more intelligible when we recognize the state origins of corporation law, and the recent inability of the several states to regulate their creation.

The American corporate tradition presents a striking counterpoise to debates over the liberal tradition in American politics. The irrational mass Lockianism identified by Hartz, and the ascriptive traditions identified by Rogers Smith have co-existed by a uniquely American, and equally important tradition, a tradition of corporate group rights.[6] The subjugation of African Americans in antebellum slavery and post-bellum apartheid involved racist subordination as well as supporting an economic system dependent on slave or peonage labor. The corporate tradition is fundamentally a political-economic tradition. It requires class differentiation, including the institutionalization of corporate capitalists as the ultimate bourgeois class.

The class differentiation would come to subordinate the position of lawyers (and nearly everyone else) in the American polity. Tocqueville characterized lawyers as America's aristocracy. Lawyers now became the servants of the business class. At

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[6] Louis Hartz, *The Liberal Tradition in America: An Interpretation of American Political Thought Since the Revolution* (New York: Harcourt Brace, 1955). Rogers Smith, "Beyond de Tocqueville, Myrdall, and Hartz: The Multiple Traditions in America," *American Political Science Review*, vol.8, no. 3 (1993), 549-566. Rogers Smith, *Civic Ideals: Conflicting View of Citizenship in U.S. History* (New Haven: Yale University Press, 1977).

the same time, they took ascendancy as leaders of the new professional class that emerged in the Progressive Era.[7] Ironically, the lawyers of the businessmen were promulgators of legal rules that supported corporate capitalism. The corporate capitalists, after all, could best afford the best legal minds.

The findings of this study are very much in accord with Horwitz's analysis of legal transformation. Horwitz argues that the natural entity theory was not advocated until the late 1890's. No one in this study articulated a natural entity theory, much less justified a particular provision or approach to the corporation problem with it. They did, however, justify their creation with the artificial entity theory. Because this was the time of the fundamental transformation to corporate capitalism, the artificial entity theory should inform our understanding of corporate attributes. John Dewey ended the debate over the corporation as an entity (until the topic was again revived by Horwitz). The corporation, he argued, is just what the law says it is. He showed that a given theory could be used to justify both pro-corporate and anti-corporate positions.[8] The corporation as a rights-and-duties-bearing-unit was a construct of the legal system. What is ironic, however, is that the artificial entity informed state construction of legal rights, including the relaxation of those rights.

The American tradition of corporate organization is deeply rooted. It is a uniquely American invention, shaped in the context of American political economics. We can trace justifications for corporations to before Hamilton advocacy of the First

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7 See Robert H. Wiebe, *The Search for Order, 1877-1920* (New York: Hill and Wang, 1967).

8 John Dewey, "The Historical Background of Corporate Personality," *Yale Law Journal*, v. 35, p. 655-73 (1926).

Bank of the United States. The legal system accommodated state innovations in corporate organization at key moments in development. The courts gave corporations standing at the bar, treated it as an entity in itself, and eventually gave it Fourteenth Amendment rights to equal protection before the law. Concentrated group rights gained constitutional standing. Lockian individualism was made to accommodate corporate capitalism. The states and the courts mediated the demarcation between public and private spheres to further political economic advancement.

The corporation has had an immense impact on the operation of the American political economy. The great differentiation in wealth and thus class in not formalized in a post-feudal manner, and social mobility between classes remains a core element of both the American creed and indeed, American practice. Some individuals inevitably work their way into the corporate class, and vice versa. Nevertheless, the Madisonian observation that one's means of subsistence will deeply influence one's political views remains. Preferences in the political system are largely dependent on one's relation to corporate capitalism.

Karl Marx treated the state as the tool of the ruling class. The legal system existed to serve the imperatives of the capitalist class. The social structures that developed did so as a result of the crisis of an existing system of productive relations, and their synthesis into a new system. Capitalism followed feudalism, and the capitalism class dominated this system of production necessarily. The social structural setting was one of preferences imposed from the top down: the ruling ideas of liberty, equality, and property are the ideas of the ruling class.[9] Max Weber, by contrast, saw modern social organization as rational, legal, and bureaucratic. The development of technical expertise was essential for the development of bureaucratic control. The consequences of bureaucratic control include a tendency towards a leveling of classes in the interest of technical competence, and a plutocracy based on lengthy formal education.[10] Weber consciously considered himself to be the anti-Marx. Weber recognized the influence of the law in legitimating social and corporate organization, even as he framed a rational legal bureaucratic set of structures that evolve from ingrained traditions, from the ground up.

Business corporation law is situated at the very center of legitimate social organization for both modes of analysis. The promulgation of corporation law accommodates both top-down and bottom up modes of analysis. In the promulgation of corporation law, Marx and Weber meet. State legislatures mediate interests of the business class with interests of the wider electorate; they are the branch of government least insulated from popular pressures, but must also respond to the larger structural forces impacting the local political economy. They construct laws that legitimate Weberian social organization; the result of that organization establishes a means of production whereby individual preferences form.

There are several implications that follow from this work. The first has to do with the connection between property rights and efficiency. North underspecifies the

[9] See for example, “The Communist Manifest” and “The German Ideology,” in Karl Marx, *Selected Writings* (Lawrence H. Simon, ed.) (Indianapolis, IN: Hackett, 1994).

[10] Max Weber, *The Theory of Social and Economic Organization* (Talcott Parsons, ed.)(New York: Free Press, 1964 [1947]), 328-341.

role of the state in facilitating property rights.[11] In his view, efficiency comes from proprietary inventiveness facilitated by clear and stable property rights. A good property rights regime directs profits to owners, such that private returns more closely approximate social returns. This is ownership in the Coasian sense.[12] Corporate rights are also property rights. They facilitate decentralized ownership with centralized control of productive assets. They also set a rational legal mode of social organization in the Weberian sense. The political process of legal change is thus a mediating variable for economic growth.

Coase, like North, does not seem to think the substantive character of property rights has an impact on efficiency: so long as the law is both clear and stable, the content of those rights will not affect the overall social product (although it will have distributional consequences.) Berle and Means were concerned with the law, and with shareholder control over their property, but efficiency was not their primary concern.[13] The Chandlerian imperative suggests that business is more efficient if Berle and Means' shareholders don't have control, but are merely investors. Against this background, I argue that the corporate form of economic organization allows Chandlerian efficiencies, and further, that corporation law must permit this. Changes in the law are necessary in order to achieve the Chandlerian emergence of the large corporation. The law does impact the overall social product. With laws enabling the

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[11] Douglass C North, *Structure and Change in Economic History*, (New York: Norton, 1981).
[12] R. H. Coase, "The Problem of Social Cost," 3 *The Journal of Law and Economics* (1960),1-44.
[13] Adolf A. Berle, Jr., and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932).

large corporation, there can be greater efficiency than otherwise.[14] This is the case even if some firms achieve great size primarily as a result of power rather than efficiency. As long as some significant proportion of firms provide efficiencies due to size and managerial coordination, the relation of the state to the increase in social wealth remains.

This critique impacts our understanding of free markets. A central tenet of neoclassical economics is that the state should interfere with markets as little as possible. Yet state promulgation of corporate rights indicates a constitutive role for the state in economic development. When economic growthis dependent on corporate capitalism, state action and sanction is essential. Polanyi argued long ago that markets are not natural. Neither, I submit, are the players when it comes to corporate capitalism.

As a result, this critique can also be used as a justification for remedial action from within a natural rights individualist perspective. One possible remedy to state sponsored concentration of wealth is taxation of the beneficiaries. Double taxation of corporate profits is often decried as unjust; the state taxes income once when declared by the corporation, and a second time when declared by the shareholder. The criticism of double taxation might make sense under a partnership theory of the corporation, but it cannot be justified under any conception of the corporation that includes state

[14] One interpretation of the Coase theorem is that it operates under conditions of perfect information and zero transaction costs. If one is to adopt this view, of course, then it cannot be applied to real world situations of positive information and transaction costs. Also, under zero information and transaction costs there is no need for a firm under Coase's theory, because the very rationale of the firm is to reduce transaction costs. Note that for Chandler, by contrast, managerial coordination is more efficient than market transactions, both because of the reduction in transaction costs but also because of the superior efficiency of centralized coordination and planning.

granted rights. The theoretically justified remedial action need not merely be double taxation, of course. Other sorts of remedial action could be proposed and justified as well. The appropriate remedy is most likely to be a function of the political process, just as are corporate rights themselves. From within the liberal tradition of sacrosanct property rights, we might not be able to theoretically specify the most appropriate remedial action, but we most certainly cannot exclude a welfare state.

Of course, we need not remain within the strictures of modern conservatism to analyze the propriety of state action in relation to economic development. McCloskey noted that founders did not have the same notion of privileging property rights that was later implicated to them by conservative thinkers.[15] This is supported by Hartz's study of economic policy in Pennsylvania before the Civil War, and by the Handlin's parallel study of Massachusetts during that same time.[16] But in any case, the statutory foundations of corporate capitalism must inform our analysis of economic development.

A second implication is directed to efforts by some neoclassical scholars who have sought to treat the corporation as merely a "nexus of contracts."[17] In the "nexus

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15 Robert Green McCloskey, *American Conservatism in the Age of Enterprise: A Study of William Graham Sumner, Stephen J. Field, and Andrew Carnegie*. Cambridge, MA: Harvard University Press.

16 Louis Hartz, *Economic Policy and Democratic Thought: Pennsylvania, 1776-1860* (Chicago: Quadrangle Books, 1968 [1948];: Oscar Handlin and Mary Flug Handlin, *Commonwealth, A Study of the Role of Government in the American Economy: Massachusetts, 1774-1861* (New York: New York University Press, 1947).

17 See for example, Steven N. S. Cheung, "The Contractual Nature of the Firm," *Journal of Law and Economics*, v. 26, n. 1 (April 1983), 1-21; Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, *Journal of Financial Economics*, v. 3 (1976), p. 305; Eugene F. Fama and Michael C. Jensen, "Separation of Ownership and Control," *Journal of Law and Economics*, v. 26, n. 2 (June 1983), 301-325; Oliver Williamson, "Corporate Governance," *Yale Law Journal*, Vol. 93, n. 7 (June 1984), 1197-1230. For a critical appraisal see William W. Bratton, Jr., "The "Nexus of Contracts" Corporation: A Critical Appraisal,

of contracts" view the corporation is a contractual entity, and all shareholders, managers, directors, and employees make contracts in exchange for their services. In this they reduce all corporate interests to individual interests. The advent of this contractual theory of the firm began with a 1972 article by Alchian and Demsetz, which treats internal corporate transactions as identical to market transactions. They argue that "Telling an employee to write this letter rather than file that document is like telling a grocer to sell me this brand of tuna rather than that brand of bread. I have no contract to continue to purchase from the grocer and neither the employer nor the employee is bound by any contractual obligations to continue their relationship."[18] The central figure of the firm can not impose authoritarian control, but rather makes contracts that others agree with because it leads to more efficient production. Thus firms are the central nexus where individuals contract with each other.[19] This line of analysis draws on Ronald H. Coase's "The Nature of the Firm," from 1937.[20] There, Coase argued that the existence of firms could be explained by a theory of transaction cost reductions: firms exist when they can operate with lower transaction costs than would otherwise occur with market transactions.

In this perspective the market is natural. The firm is an artificial creation that is reduced to the individuals that compose it, each seeking individual utility

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Cornell Law Review, v. 74, p. 407-465; 1989, William W. Bratton, Jr., "The New Economic Theory of the Firm: Critical Perspectives from History, Stanford Law Review, v. 41 (1989), 1471-1527; and David Millon, "Theories of the Corporation," *Duke Law Journal*, (1990), 201-262.

[18] Alchian and Demsetz, "Production, Information costs, and Economic Organization" *American Economic Review* 62:777 (1972), p777.

[19] Bratton identifies two distinct strands of new economic theory, a "neoclassical" variant, and an "institutional" variant. William W. Bratton, "The "Nexus of Contracts" Corporation: A Critical Appraisal," *Cornell Law Review,* vol. 74 (1989), 407-465, at 417-23.

[20] Ronald H. Coase, "The Nature of the Firm," 4 *Economica* (1937), 386.

maximization. The pre-political right to contract among independent actors is preeminent legal relationship. Shareholders are owners, managers are specialists at organization, and the corporation is nothing more that a contractual agreement among participants to seek efficiency. If workers are unhappy with their condition, they can negotiate a new contractual relationship, elsewhere if necessary. Shareholders can trade shares if they are unhappy with management, and purchasers can select other goods that that offered. Separation of control from ownership results from specialization in risk-bearing by owners, and specialization of decision making by management.[21]

This picture of the firm is one of private actors. Government appears to have no role except as enforcer of contracts. The key analytic move for this set of theories is the assertion of free choice by actors to their place within the corporate nexus. Yet as Bratton notes, contract theory includes relational aspects as well as mutual consent notions.[22] In addition there are also contractual issues such as the problem of imperfect contracts, contractual misunderstandings, unforeseen circumstances not accounted for in the contract, and dynamics in long-term relationships that cast doubt on the notion of consent.

The nexus of contract theory elides the history of statutory construction in the states. Corporations received rights and privileges in particular settings in the states. A legal environment within the American political system provided those rights. State

[21] Eugene F. Fama and Michael C. Jensen, "Separation of Ownership and Control," *Journal of Law and Economics*, v. 26, n. 2 (June, 1983), 301-325;

[22] Bratton, "The "Nexus of Contracts" Corporation," 448-451.

construction of corporation rights has led to an increase in overall social wealth, combined with a concentration of that wealth in relatively few hands. The sharp distinction that nexus contract theorists make between the private and the public spheres erodes under the dynamic of state-aided wealth accumulation. Further, as inequality increases, not all parties to a bargain have similar leverage over contract negotiations. Thus the nexus of contract theory is also subject to the same criticism made by critics of the *Lochner*[23] decision, namely that disparities in bargaining power can lead to subordination.

A third implication concerns a recent debate in comparative political economy that has questioned the trajectory of corporate governance structures. The "Varieties of Capitalism" approach distinguishes Liberal Market Economies (LME), typified by the American case, from Coordinated Market Economies" (CME),[24] typified by the German mode. The former are characterized by the use of market mechanisms to coordinate industrial relations, relations to finance capital, education relations, and labor relations. Inter-firm relations are governed by an antitrust tradition, with a diffusion of ownership. The CME model is characterized by coordinated industrial relations, financial relationships, education relations, and labor relations.[25] Crucial debates concern the comparative advantages of each system under various conditions. For example, CME systems have lower transaction costs while LME systems are better

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23 *Lochner v. New York* 198 U.S. 45 (1905).

24 Also called "Organized Market Economies" (OME).

25 See in particular the introduction by Hall and Soskice, but more generally the entire edited volume Peter A. Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (New York: Oxford University Press, 2001). Note also that the OME model has not been performing well lately.

capitalized and are more adept at allocating capital to newly productive areas.[26]

One area of debate is whether these systems are converging or diverging in the new global economy. A second area of debate concerns the sources of variation in organization. Peter Gourevitch, for example, suggests that the German and American models looked more similar in 1890 that they do today, pointing to political and legal acts that pushed the United States closer to the LME model.[27] My point in addressing this debate is simple: an analysis of the origins of the American system of corporate organization must take into account the statutory foundations, as well as the federal structure of the American system. The future trajectory of legal rights necessary for rapid economic development may be informed by the leading trajectory from the past.

The American experience in the states suggests an analog for the "Varieties of Capitalism" debates. The American system then operated under the understanding that the federal government was a limited government of assigned powers. The federal government as a result involved itself in two ways. First, any federal regulation would be the antitrust variety. Second, the Supreme Court acted to protect the national market, and limit federal intervention in the economy. The result was a roughly anarchical system that parallels elements of the modern anarchical economic system in important ways. There is no central authority, and thus states seek to position themselves according to their local political and economic conditions in the absence of that. Rather than building a national economy, the current effort is to build a global

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[26] See Peter Gourevitch, "Corporate Governance: Global Markets, National Politics," in Miles Kahler and David A. Lake, *Governance in a Global Economy: Political Authority in Transition* (Princeton, N.J.: Princeton University Press: 2003), 305-331.

[27] Id., 318-9.

economy. Obviously, there is greater variation in politics, economics, and culture than existed in late nineteenth century America. There is also a far greater capacity for communication. The parallel is obviously inexact, but includes similarities enough to give us pause. The extent to which the modern state must give up control over its national political economy in the face of globalized markets is and will be a source of political contention for the foreseeable future. It in itself portends a crisis of political economic orthodoxy in the face of transforming market relations. A change in mindset will be a likely result.

The concentrated capital thesis remains to be tested in relation to contemporary economic practice. Nevertheless, the findings already point to possibilities for research in comparative political economy. Rostow's analysis of economic growth suggests an organic process that begins with small proprietary capitalism, followed by a germinated period that leads to industrial take-off.[28] Small manufacturing, along with cultural acceptance and appropriate education set the stage for a take-off towards rapid industrial development. From small firms grow large firms. This research indicates a more complicated process: states with extensive small manufacturing tend to resist laws that encourage the concentration evident in the large industrial corporation. In Rostow's analysis each nation is hermetically sealed from its neighbors. This analysis suggests one important way in which cross border influences disrupt any such organic process. Corporate development in America required legal "cousins" that subverted the will of states with extensive small manufacturing. States

[28] W. W. Rostow, *The Process of Economic Growth, 2nd ed. (*New York: Norton, 1962).

with extensive small scale manufacturing may not want an economic powerhouse to dominate the local economy, unless it provides markets for the local producers. Yet a nearby state can subvert state sovereignty under otherwise free market conditions. Organic growth following a germination period need not occur. It is possible this analysis may inform studies of import substitution industrialization strategies attempted in a developing countries. Whether patterns of development in these countries are impacted by the prior concentration of industrial production may be an intriguing line of research.

Finally, debates in the legal profession have been over whether the federal system of charter specialization has resulted in a "race to the bottom" which has resulted in the lowering of social standards, or a "race to the top" that has promoted economic efficiency. William Cary initiated debate by arguing that state competition led states to favor management at the expense of shareholders because it is the managers who are in a position to shop among states for the most favorable charter.[29] Daniel Fischel argued that the resulting economic efficiencies led to a "race to the top."[30] By contrast Lucien Bebchuk and Allen Ferrell argue that economic inefficiencies have been the result.[31] This dynamic has taken on an international tone as many U.S. corporations have located their place of incorporation to Bermuda. This contemporary dynamic is best understood with knowledge of how corporate rights

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[29] William Cary, "Federalism and Corporate Law: Reflections Upon Delaware," *Yale Law Journal,* (1974) 83: 663-705.

[30] Daniel R. Fischel, "The 'Race to the Bottom' Revisited: Reflections on Recent Developments in Delaware's Corporation Law", *Northwestern University Law Review*, (1982) 76: 913-45.

[31] Lucien Arye Bebchuk and Allen Ferrell, "Federalism and Takeover Law: The Race to Protect Managers from Takeovers", *Columbia Law Review* (1999), 1165, 1168.

evolved in history.

The variety of corporate legal rights in the statutory record and their alteration over time sheds light on the foundations of corporate capitalism. It suggests potential tools for control of the corporation by the state. The raises the question of whether a federal law for incorporation would facilitate greater state regulation. It is possible, for example, that the U.S. Federal Government might have greater leverage to with federal charters. In this I am a pessimist. Corporate capital can influence federal policy as well as it can Delaware policy.

In practice, access of foreign corporations to domestic markets is probably just as important is access of foreign companies to domestic markets. The United States would seem to have one of the most attractive markets in the world (if not the most attractive), and thus might seem to have leverage, for example against corporations chartered in Bermuda. Yet politics in the contemporary scene insulates legislators against popular pressures on issues that tend to lack in depth media coverage. Legislators are obviously susceptible to influence from corporate money. One suspects that a federal system of charter laws would be about as effective in controlling corporate abuse as tax law has been in reducing the number of charters taken out in Bermuda. In any case, it appears that the time for statutory control of the corporation has long past. A new system of economic organization is emerging, and it is not likely to be anything that anyone intended.

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